BANKING IN INDIA

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PREFACE TO THE FIRST EDITION

THE authoritative and exhaustive banking enquiry of 1929-31 has made enormous material (20,000 pages in print) available for the study of banking in India. But it is too vast, confusing and technical for the ordinary reader. Even the reports of the Central and Provincial Banking Committees, with their dissenting minutes, are not free from these drawbacks. Moreover, important developments in banking have taken place since the completion of the enquiry. The aim of the following pages, therefore, is to give a clear and up-to-date account of banking in India, within a reasonable compass and in as simple a language as possible, for the benefit of the ordinary reader. The writer has endeavoured to make a full use of all the material available regarding the subject.

PREFACE TO THE TENTH EDITION

As several important developments have taken place in the banking system of India since the publication of the ninth edition of this book, this tenth edition also has been thoroughly revised and brought up-to-date, and some of the chapters have been partly rewritten or enlarged.

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Page	*Line*	*For*	*Read*
51	fn.	Punjamb Comittee	Punjab Committee
57	12	Regultion	Regulation
165	fn.	Book	Bank
260	16	delete the sentence "They have not been set up."	
336	24	authoity	authority

CHAPTER I

PROGRESS OF BANKING IN INDIA

1. *Indigenous Bankers.*—Although evidence regarding the existence of money-lending operations in India is found in the literature of the Vedic times, *i.e.* 2000 to 1400 B.C.,[1] no information is available regarding their pursuit, as a profession by a section of the community, till 500 B.C. From this time onwards, India possessed a system of banking, which admirably fulfilled her needs and proved very beneficial to her, although its methods were different from those of modern Western banking. The literature of the Buddhist period supplies ample evidence of the existence of *sresthis*, or bankers, in all the important trade centres and of their wide-spread influence in the life of the community. Their chief activity was to lend money to traders, to merchant-adventurers who went to foreign countries, to explorers who marched through forests to discover valuable materials, and to kings who were in financial difficulties due to war or other reasons, against the pledge of movable or immovable property or personal surety. Usury was practised but was held in contempt. From the laws of Manu, it appears that money-lending and allied problems had assumed considerable importance, and that deposit banking in some form had come into existence by the second or third century of the Christian era.[2] Kautilya's *Arthasastra* laid down 15 and 60 per cent. as the maximum legal rates of interest per annum on secured and unsecured loans respectively, but permitted a maximum of 240 per cent. if the risk was specially heavy.

Hundis or indigenous bills of exchange came into use from the 12th century, and it appears from the writings of a few Muslim historians, European travellers, State records and the *Ain-i-Akbari* that both under the early Muslim and Mogul rulers in India indigenous bankers played a prominent part in lending money, financing internal and foreign trade with cash or bills, and giving financial assistance to rulers during periods

1 See Vedic Index of Names and Subjects by Macdonnell and Keith, Vol. I p. 109.

2 See *Cambridge History of India*, Vol. I, p. 218.

of stress. No exact information is available regarding the rates of interest charged by them, but it appears from the evidence that is available, that they were higher than those prescribed in Kautilya's *Arthasastra*.

During the Mogul rule the issue of various kinds of metallic money in different parts of the country gave the indigenous bankers great opportunities for developing the very profitable business of money-changing and the most important among them were appointed mint officers, revenue collectors, bankers and money-changers to Government in various parts of the Empire. Many of them wielded great influence in the country, and those among them who came to be known as Jagat Seths (world bankers) in the 17th and 18th centuries possessed as great a power as the private bankers of any Western country. The indigenous bankers, however, could not develop to any extent the system of obtaining deposits regularly from the public and paying interest on them, and those who made savings either hoarded them, or lent them to friends and neighbours. The reason seems to be that many of them combined trade with banking business; this combination reduced the stability of their banking business, and produced an unfavourable reaction upon banking development in India.

The English traders that came to India in the 17th century could not make much use of the indigenous bankers owing to their ignorance of the latter's language and owing to the latter's inexperience of the finance of the former's trade. Therefore, although the East India Company established connections with the bankers, borrowed funds from them, and for the first few years collected a portion of the land revenue through them, the English agency houses in Calcutta and Bombay began to conduct banking business besides their commercial business. From this time, the business and power of the indigenous bankers began to wane, although the East India Company successfully prevented the establishment in India of banking on Western lines for a considerable time, on the ground that the agency houses and the indigenous bankers were more suited to the banking requirements of the country.

Other causes also operated to bring about the decline of the indigenous bankers. The continuous warfare and chaos that resulted from the break-up of the Mogul Empire seriously

checked their activities. Some of them were at times unable to fulfil their promises, had to resort to questionable practices, and found their claims not infrequently evaded by their debtors, some of whom were ruling princes. Further, they lost their profitable money-changing business from 1835, when a uniform currency was established throughout the country. Moreover, the diversion of trade from old to new routes and the change in the basis of India's trade relations with other countries, that were brought about by the development of railways, steamships, post and telegraph, affected their business adversely. Their decline and the gradual expansion of English trade and power in India led the East India Company to abandon its opposition to the establishment of banks on Western lines in India. Consequently, such banks and Government treasuries came to be established, and they accentuated the decline of the indigenous bankers.[1] With reduced resources and a smaller scale of business they began to find themselves handicapped in their competition with commercial banks, and they began gradually to lose ground to them, just as in England the private family bankers had to give place to the larger joint-stock banks.

They continued to have a distinct and separate existence from the joint-stock banks. Consequently, these two important parts of the banking system have remained ignorant of the doings and methods of each other, with loss to both of them. The indigenous bankers have mostly continued their antiquated methods, and have learnt little from the more efficient and advanced methods of the joint-stock banks. The latter have not learnt the economy and simplicity of the former and the traditions of the people, and have not been able to penetrate into rural areas in which the vast bulk of the people live. In spite of the progress of the joint-stock banks, a large amount of banking business is still carried on by the indigenous bankers throughout India. The work of the former has so far been restricted to the ports and the important towns. Consequently, agriculture and the internal trade in rural areas are still dependent to a large extent upon the services of the indigenous bankers. Many of them also serve as middlemen between the internal traders and the banks, discounting the hundis of the former and re-discounting them with the latter.

2. *The Agency Houses, the Presidency Banks and the Imperial*

1 See Jain, *Indigenous Banking in India, pp.* 20-23.

Bank of India.—The English agency houses in Calcutta and Bombay that began to serve as bankers to the East India Company, the members of the services, and the European merchants in India, had no caqital of their own, and depended upon deposits for their funds. They financed the movement of crops, issued paper money, and paved the way for the establishment of joint-stock banks. The earliest of these was the Hindustan Bank, which was established in 1770 by one of the agency houses in Calcutta, and its business was closely connected with these houses. But it was wound up in 1832, when the firm of Alexander and Company, with which it was intimately connected, failed. The Bengal Bank and the General Bank of India were established about 1785. The latter was voluntarily liquidated in 1791 owing to inability to earn profits, and the former failed a little later owing to a severe run upon it caused by the temporary reverses inflicted upon the Company by Tipu Sultan. These banks were chartered by the East India Company, and were followed by banks established under Acts of the Indian legislature. The latter may be divided into two groups, the first consisting of the three Presidency Banks amalgamated into the Imperial Bank of India in 1920, and the second, of the Indian joint-stock banks.

The Bank of Bengal, the first of the Presidency Banks, was established in 1806 as the Bank of Calcutta, and received its charter as the Bank of Bengal in 1809. The East India Company regarded it necessary to facilitate its own borrowings, as well as to facilitate the operations of the English traders. In order to be able to share in the direction of the bank's business so as to keep it within safe limits, the Company contributed one-fifth of the banker's capital of £500,000, and obtained the right to appoint three of its directors. Its secretary was generally a member of the Civil Service. The charter imposed certain restrictions on its working. In 1823 it was allowed to issue notes, and in 1839 to open branches and to deal in inland exchange, but not in foreign exchange.

The Banks of Bombay and Madras were established in 1840 and 1843, with a share capital of Rs. 50 and Rs. 30 lakhs respectively, out of which the East India Company provided Rs. 3 lakhs in each case and obtained the right to appoint some of their directors. Their secretaries and treasurers were members of the I.C.S. Both the banks were allowed to issue notes

up to a certain amount. The bulk of the shares of all the three banks were subscribed by Europeans. All of them were given the monopoly of Government banking. In 1862 their right of note issue was taken over by Government, and as compensation they were given the use of Government balances in the Presidency towns free of charge.

The Bank of Bombay became involved in the wild speculation of 1862-5 that followed the American Civil War and the rise in the price of cotton, suffered serious losses, and was voluntarily wound up in 1868, but a new bank having the same name was established immediately afterwards with a capital of Rs. 1 crore. Although the depositors were repaid fully, the shareholders of the defunct bank lost nearly the whole of their capital. After this failure, Government withdrew its portion of the capital from the other two banks, and gave up its right to appoint a proportion of the directors and the secretaries and treasurers of all the three banks.

The Presidency Banks Act imposed restrictions upon all the three banks to safeguard the interests of Government and the public which deposited funds with them. The chief restrictions were firstly that they were prohibited from dealing in foreign bills, and borrowing abroad as exchange business was regarded risky; secondly, that they were prohibited from lending for more than six months; and finally that they were prohibited from lending on the security of immovable property, as it was not easily saleable. In return most Government banking work was retained in their hands, and the prestige that this gave them enabled them to secure a large amount of other banking business. These restrictions undoubtedly contributed a great deal to their stability, and in spite of them the banks showed much vitality and power of expansion. But the restrictions were continued even after the banks had built up a very solid position by careful management and after exchange transactions had ceased to be speculative owing to the establishment of the Gold Exchange Standard. Their unnecessary continuation made the working of the banks out of date, and prevented them from playing as useful a part in the Indian financial system as they might otherwise have done.[1]

The Presidency banks established branches at many important trade centres in India, but they lacked points of contact,

1 Cf. Keynes, *Indian Currency and Finance*, p. 204.

the want of which was often deplored. On many occasions it was felt strongly that there should be only one bank of this kind for the whole country. From 1860 to 1876 the possibility of the conversion of the Bank of Bengal into a "Bank of India" was under consideration. In 1867, the Secretary and Treasurer of the Bank of Bengal placed before the Government of India a project for the amalgamation of the three Presidency Banks. But the Government of India did not favour it on the grounds that the interests of such a big institution might run counter to those of the public; that its influence might overshadow that of the Government itself; that it would be very difficult to manage; and that the merchants of the other two important trade centres, *viz.* Bombay and Madras preferred, and were entitled to, separate Banks to promote their own interests and convenience.

In 1898 some witnesses before the Fowler Currency Committee advocated the establishment of a Central Bank, but the Government of India under Lord Curzon did not favour the proposal. The Presidency Banks themselves desired to retain their individuality, and were opposed to amalgamation. The Chamberlain Currency Commission of 1913 merely suggested the appointment of a small expert committee in India to examine the question. The banking crisis of 1913-17, however, showed clearly the defects and dangers of India's free banking system, under which the country had no co-ordinated banking policy, and each bank conducted its business entirely in its own way, without any control of a central institution. This lesson was reinforced by the experience obtained during the latter part of the War. Co-operation and co-ordination of policy on the part of the Presidency Banks for financing its requirements during the latter part of the War showed the advantages and wisdom of this policy. Finally, the danger arose that if the Presidency Banks were to remain isolated, one of the big five English Banks, or Japanese or American Banks might secure excessive influence and predominance in the financial system of India, by amalgamating with, or absorbing, some of the banks in India.[1] Public opinion in India, therefore, strongly urged the creation of a Central Bank; the Presidency Banks and Government withdrew their opposition to the project; and an Act of 1920 amalgamated the three Presidency Banks

1 See Ramachandra Rau, *Present Day Banking in India*, p. 32.

into the Imperial Bank of India. At the time of amalgamation they had altogether 70 branches, a total paid-up capital of Rs. $3\frac{3}{4}$ crores and a total reserve of almost Rs. $3\frac{1}{2}$ crores.

It was intended in 1920 that the Imperial Bank should gradually be developed into a full-fledged Central Bank. In 1926, however, the Hilton Young Currency Commission recommended the creation of a separate bank, to be called the Reserve Bank of India, to perform central banking functions, so as to leave the Imperial Bank entirely free, not only to continue, but also to extend commercial banking activities, the need for which was urgent in the country. The Commission further recommended that the Reserve Bank should be a shareholders' institution, and that the members of the Indian legislatures, central and provincial, should be debarred from serving as directors of the Bank, so as to eliminate the danger of political pressure being exercised on the boards of the Bank. A bill incorporating these recommendations was introduced by Government in the Legislative Assembly in 1927, but was withdrawn, because the Assembly desired the Bank to be a State institution and a proportion of its directors to be members of the legislature in the peculiar conditions of the country, but contrary to the principles of sound central banking generally accepted in other countries. In 1933, the British Government made the creation of a Federation and Responsible Central Government in India dependent upon the previous establishment of the Reserve Bank of India, and so another bill providing for the establishment of the Bank was introduced in the Central Legislature in 1933, and was passed in 1934, and the Bank commenced its work in 1935.

The progress of the three Presidency Banks taken together from 1870 to 1920, of the Imperial Bank of India from 1921 to 1954 and of the State Bank of India from 1955 to 1961 is shown by the table on p. 8.

3. *Indian Joint-Stock Banks.*—The real stimulus for the establishment of joint-stock banks was provided by an Act passed in 1813, which removed all restrictions on Europeans settling in India. Several banks were established on the basis of unlimited liability, mainly by the English agency houses. They conducted ordinary banking business, financed internal trade, and issued notes. One of them also gave loans to industries, and transacted exchange business, and another acted as

PROGRESS OF THE THREE PRESIDENCY BANKS 1870-1920, THE IMPERIAL BANK FROM 1921-1954 AND THE STATE BANK OF INDIA FROM 1955-1961 TAKEN TOGETHER

(*in Crores of Rupees*)

Year	Paid-up Capital	Reserve and Rest	Government or Public Deposits	Private Deposits	Cash Balances	Invest-ments	Loans and Advances including bills discounted	*No. of Offices.
1870	3.36	.25	5.43	6.40	9.79			
1880	3.50	.55	2.91	8.49	7.41			
1890	3.50	.97	3.59	14.76	12.97			
1900	3.60	2.00	2.80	12.88	5.04			
1910	3.60	3.31	4.24	32.34	11.35			
1920	3.75	3.78	9.03	78.02	26.03			
1921	5.62	4.15	6.80	65.78	13.60	12.46	53.90	88
1922	5.62	4.33	14.16	57.01	15.07	9.79	54.51	106
1923	5.62	4.55	8.57	74.19	15.01	12.18	70.71	149
1924	5.62	4.80	7.50	76.71	15.60	16.37	61.40	165
1925	5.62	4.73	5.46	77.83	17.47	17.01	56.45	181
1926	5.63	5.09	6.45	73.90	20.90	19.15	48.02	183
1927	5.63	5.24	7.20	72.07	10.89	18.59	61.53	198
1928	5.63	5.39	7.95	71.30	10.58	21.76	61.60	202
1929	5.63	5.48	7.60	71.64	14.00	33.00	40.59	203
1930	5.63	5.53	7.37	76.60	13.04	29.25	49.58	206
1931	5.63	5.14	8.32	63.86	11.03	30.27	41.58	201
1932	5.63	5.43	7.07	68.36	20.97	32.04	30.60	201
1933	5.63	5.49	6.44	74.13	18.60	47.03	22.99	202
1934	5.63	5.66	7.72	74.28	18.97	41.56	29.02	221
1935	5.63	5.47	From 1935	79.10	19.59	46.88	21.58	228
1936	5.63	5.50	Government	78.80	8.56	52.59	26.76	269
1937	5.63	5.50	deposits were	81.08	13.43	47.62	29.37	319
1938	5.63	5.55	transferred	81.51	8.99	43.72	38.30	358
1939	5.63	5.60	to the	87.84	11.09	38.02	48.28	381
1940	5.63	5.62	Reserve Bank	96.03	24.83	48.57	32.31	390
1941	5.63	5.62	of India	108.92	15.27	64.39	38.88	401
1942	5.63	5.75		163.46	23.00	116.41	33.79	398
1943	5.63	5.85		214.53	53.36	130.20	40.60	404
1944	5.63	6.00		237.78	28.31	148.63	70.23	419
1945	5.63	6.07		259.37	41.60	154.18	72.97	426
1946	5.63	6.17		271.67	42.45	154.53	94.27	358 (87)
1947	5.63	6.25		286.59	42.89	164.19	89.15	362 (86)
1948	5.63	6.27		280.29	43.67	161.25	98.00	307 (84)
1949	5.63	6.30		250.46	66.89	106.85	91.81	377 (36)
1950	5.63	6.33		231.37	28.78	121.55	101.95	382 (36)
1951	5.63	6.35		230.91	28.57	85.16	142.47	393 (30)
1952	5.63	6.35		205.85	25.45	113.17	97.14	410 (12)
1953	5.63	6.35		206.97	19.64	106.30	94.12	424 (12)
1954	5.63	6.35		231.13	36.36	102.31	108.71	455 (11)
1955	5.63	6.35		219.80	29.37	116.96	105.80	484 (11)
1956	5.63	6.37		235.45	27.77	106.87	140.15	538 (8)
1957	5.63	6.63		366.68	39.41	183.54	173.46	622 (8)
1958	5.63	7.00		478.68	55.47	384.55	172.06	712 (8)
1959	6.63	7.20		582.11	64.83	377.92	166.87	823 (8)
1960	5.63	7.45		577.35	67.92	306.75	232.24	901 (8)
1961	5.63	8.20		†531.33	63.93	229.89	255.32	954 (8)

Ref. Statistical Tables relating to Banks in India.

*Includes offices in Burma up to 1943. Figures in backets from 1946 indicate offices outside the Indian Union.

† Decline due to transfer of a part of the U. S. P.L. 480 funds to Reserve Bank.

banker to the East India Company. But most of them came to grief during the crisis of 1829-33, owing to the combination of banking with other business and speculation, mismanagement, and fraudulent use of their funds, although they were managed entirely by Europeans, and although the Company assisted some of them during the crisis. After the crisis, several new banks were started by European houses on the basis of unlimited liability, but half of them failed by 1860 owing to speculation and mismanagement permitted by careless auditing of their accounts, although these also were managed by Europeans. Some of them, however, achieved considerable success, and two had branches in India and London.

In 1860, an Act was passed permitting the starting of joint-stock banks on the basis of limited liability, as it was essential to enable large business companies to secure the large amounts of capital that they needed, but soon afterwards the banks were deprived of the right of note issue. Then came the American Civil War which, by cutting off the supply of American cotton to England, caused an unprecedented boom in India's cotton trade with England, and led to an orgy of speculation. A large number of banks and all sorts of other companies were formed to take part in this activity, but all of them failed in a short time, and destroyed public confidence in banks. Further, the currency confusion during 1873-93 caused trade uncertainties, and created an atmosphere unfavourable to the establishment of new banks. Consequently, from 1865, till the end of the century, the progress in the creation of joint-stock banks was very slow. At the end of the century there were only 9 banks with capital and reserves of over Rs. 5 lakhs, their total paid-up capital and reserves being Rs. 1¼ crores, and their total deposits Rs. 8 crores.

The Allahabad Bank and the Alliance Bank of Simla were established in 1865 and 1875 respectively, both under European management. The latter went into liquidation in 1923, because it had locked up too large a proportion of its funds in subsidiary concerns started by Boulton Brothers of London, which it had absorbed to facilitate its London business. The Oudh Commercial Bank established in 1881, was the first bank on limited liability to be managed by Indians. It was followed in 1894 by the Punjab National Bank and in 1901 by the People's Bank of India, both of which were started chiefly through the

efforts of Lala Harkishen Lal. All of them made good progress, but the last, the most successful of them, failed in 1913; it had locked up too large a proportion of its funds in industrial investments, and when its depositors became frightened, it found its liquid resources inadequate, and the other banks declined to come to its assistance.

The Swadeshi movement that began in 1906 gave much stimulus to banking and between this year and 1913 the number of banks with capital and reserves of over Rs. 5 lakhs increased from 9 to 18, with a total paid-up capital and reserves of Rs. 4 crores and total deposits of Rs. 22 crores. The number of smaller banks established during this period was much greater. Some of the prosperous Indian banks of the present time, *viz.* the Bank of India, the Indian Bank of Madras, the Central Bank of India, the Bank of Baroda, and the Bank of Mysore were established during this period. Other large Indian banks, that were launched during the period but failed subsequently, were the Indian Specie Bank, the Bengal National Bank, the Credit Bank of India, the Bombay Merchants' Bank, the Standard Bank of Bombay, and the Bank of Upper India.

This boom was followed by a banking crisis during 1913-17. During this period 87 banks failed with a total paid-up capital of over Rs. $1\frac{3}{4}$ crores, which was slightly more than half of the total paid-up capital of all the joint-stock banks that survived in 1917.[1] The majority of them were small and weak, but at least half a dozen of them were large. The failures did much to weaken public confidence in Indian joint-stock banking and to check the growth of banking habits in India, and thus gave a considerable set-back to banking development in India. The causes of the crisis may be briefly considered here.

During the boom of the decade preceding the War a large number of mushroom banks grew up in Western India, the Punjab and the United Provinces, and having developed in good times, and not having existed long enough to remember any previous crises, they conducted their business in violation even of the elementary principles of banking.[2] They had an imposing authorized capital, but the subscribed capital was far smaller, and the paid-up capital was smaller still. The

1 See Statistical Tables relating to Banks in India for 1917, p. 2.

2 See Keynes, *Indian Currency and Finance*, pp. 223-5, Shirras, *Indian Finance and Banking*, pp. 366-7, and Rau, *Present Day Banking in India*, pp. 213-24.

aggregate subscribed and paid-up capital were only 40 and 14 per cent. respectively of the authorized capital. The law did not pre-event this malpractice, and the banks took advantage of it to dec-eive the public, which was ignorant of the differences between the three kinds of capital. The deception of the public was increased by the adoption of high sounding names by some of the banks.

The deficiency of capital made them almost wholly dependent upon deposits for conducting their business. Keen rivalry among them to attract deposits led them to offer much higher rates of interest than they could really afford, if they had conducted legitimate business only. In order to be able to pay the high rates, they employed the funds at their disposal in hazardous enterprises. Large sums were locked up in speculative dealings in silver, pearls and other commodities; long-term businesses were financed without efficient investigations into their soundness, on the chance of earning large profits, and short-term deposits were used for this purpose; too large a proportion of the total available funds was frequently sunk in a single business; and funds were lent in some cases on the security of the lending banks' own shares.

Many of the directors and managers of these banks were incapable men, and had little knowledge either of the principles or of the practice of banking. Many of the former, instead of guiding and supervising the work of the latter, allowed themselves to be led away by the latter. The shareholders, as a rule, were too ignorant or apathetic to exercise their rights and duties and to control either the directors or managers. Many of the latter resorted even to dishonesty, fraud or criminal mismanagement, and could continue it owing to the connivance of auditors, who were their creatures, and whose auditing of the banks' accounts was more or less a farce. Thus, they lent the funds of the banks, of which they were the directors or managers, to themselves or to concerns in which they were directors or partners; they made away with the assets of the banks by showing in the books debts due to the banks that did not exist. To hide this mismanagement and fraud, the books were in some cases left in an incomplete state, not being written up to date, or they were falsely made up; window-dressing was freely resorted to in making up the balance-sheets and in a few cases dividends were paid out of capital and, if that had disappeared, out of deposits. It is, therefore, not surprising

to find that very low cash reserves were kept, amounting in the aggregate to no more than 11 per cent. of the liabilities; many of the smaller banks kept still smaller cash reserves. These were hopelessly inadequate to serve their purpose in a country like India, where the banking habit is still far from being formed. Even the liquid assets of many of the banks were small, most of their assets being 'slow'.

This description of the causes of the banking crisis, and failures did not apply to all the India Joint-stock banks. Many of them, especially the larger and older ones, conducted their work on sound lines and, although not as strong as the Presidency or exchange banks, were strong enough to withstand the crisis without untoward consequences. The description applies chiefly to the small banks which had rapidly sprung up after 1904. No conclusion can be drawn from the bank failures regarding the capacity of Indians to manage joint-stock banks, because a large number of such banks have failed in every Western country during the early part of the development of its joint-stock banking. The crisis was aggravated by the complete absence of co-operation between the Indian joint-stock banks themselves, and between them and the Presidency and exchange banks. The Bank of Bengal declined to lend to the banks that were in difficulties in Lahore even against Government securities. This was the result of the complete decentralization of the Indian banking system, *i.e.* of the absence of a central bank, which in a Western country guides the general banking policy of the country and endeavours to mitigate a crisis by remedial action.[1]

There was a brief respite in bank failures from 1918 to 1921 during which only 21 banks with a total paid-up capital of Rs. 14 lakhs failed. The boom during the latter part of the War and after it gave another impetus to the starting of banks, and a number of banks were established, some specially for financing industries, the chief of which was the Tata Industrial Bank. But from 1922, the number of failures increased once more owing to economic depression, the number during 1922-36 being 373 with a total paid-up capital of Rs. 6 crores 82 lakhs. The most important failures were the Alliance Bank of Simla, mentioned before, the Tata Industrial Bank in 1923, and the

1 *Cf.* Pandit Malaviya's note to the Report of the Indian Industrial Commission pp. 337-8.

People's Bank of Northern India in 1932. The Tata Bank had to be merged into the Central Bank of India, because it had combined long-term credit to industries with ordinary commercial banking business, and had financed both out of current and annual deposits instead of financing the former by issuing bonds, and because it was managed by Europeans, most of whom had no previous experience of India.[1] The People's Bank of Northern India failed on account of adverse economic conditions in the Punjab in which its work had been concentrated. Of the 481 banks that failed in the country during 1913-36, 89 were in the Punjab, 64 in the United Provinces and 57 in Bombay, while Burma and the Central Provinces had only 3 and 1 failures respectively. The reason is that from the Swadeshi movement of 1906 most of the new banks were established in the Punjab and the United Provinces, the wheat producing provinces of India, and in Bombay, one of the chief ports and a centre for speculative activities, chiefly in cotton and silver.[2] In 1936, 40 banks failed in Travancore, as too many small banks had sprung up there recently. During 1937-48, 620 more banks failed, the most important being the Travancore National and Quilon Bank in 1938.

The above tendencies in the development of Indian joint-stock banking from 1913 are reflected in the table of its total deposits (p. 14), which are the best indication of the public confidence enjoyed by banks.

The conversion of actual deposits in terms of the pre-First War price level is necessary because 1918-21 were years of inflation, and were followed by depression, but the conversion shows no radical change in the trend. The deposits fell sharply after the commencement of the crisis, and did not recover fully till 1917. They increased rapidly during, 1918-21, but fell sharply once more in 1922 and 1923, and did not recover to a considerable extent till 1928. The figures thus bring out the weakness of Indian joint-stock banking when economic conditions become unfavourable. However, between 1917 and 1937, while the deposits of the Indian banks were more than trebled, those of the Imperial Bank and the Exchange banks increased by 33 and 20 per cent. only. During the second World War also their deposits increased substantially. But after partition they fell and began to increase from 1953.

1 *Cf.* Thakur, *Organization of Indian Banking*, p. 35.
2 *Cf.* Jain, *The Monetary Problems of India*, p. 100.

TOTAL DEPOSITS OF INDIAN SCHEDULED BANKS, EXCEPT IMPERIAL OR STATE BANK AND NON-SCHEDULED BANKS 1913-1961

Year	Actual deposits in crores of Rs.	Deposits converted to pre-War value	Year	Actual deposits in crores of Rs.	Deposits converted to pre-War value
1913	24	24	1938	107	96
1914	18	17	1939	113	100
1915	19	18	1940	130	104
1916	26	20	1941	155	108
1917	32	23	1942	223	114
1918	42	27	1943	365	133
1919	61	36	1944	510	151
1920	73	40	1945	644	159
1921	80	46	1946	673	
1922	65	40	1947	669	
1923	48	31	1948	640	
1924	55	35	1949	581	
1925	58	36	1950	596	
1926	63	42	1951	587	
1927	64	46	1952	572	
1928	66	47	1953	596	
1929	66	47	1954	653	
1930	67	56	1955	727	
1931	67	56.	1956	799	
1932	76	65	1957	909	
1933	76	66	1958	1027	
1934	82	72	1959	1173	
1935	90	79	1960	1185	
1936	104	93	1961	1300	
1937	108	97			

The progress of these banks since 1870 is shown by the figures in tables on pp. 14, 15, 16, 17 and 18.

4. *Exchange Banks.*—In addition to the banks established in India under charters of the East India Company and Acts of the Indian Legislature, a number of foreign banks with head offices abroad have carried on business in India through branches. The most important of these are English banks established under Royal Charters or English Acts. The bulk of India's foreign trade being with or *via* England, it was natural that banks should be established in London to transact exchange business with India. Until 1853, however, the East India Company, supported by the agency houses, succeeded in preventing the starting of such banks, with a single exception, for doing business in India, because the Company and the houses were afraid that the banks would profit at their expense from their annual remittances for home expenditure and other exchange transac-

PROGRESS OF INDIAN JOINT-STOCK BANKS EXCLUDING THE IMPERIAL OR STATE BANK, SINCE 1870

(Figures in Crores of Rupees)

Year	Number of banks	Capital and reserve	Deposits	Cash balances	Bills discounted and loans and advances	Investments in Govt. and other securities
Class A. Banks with capital and reserve of Rs. 5 lakhs and over						
1870	2	.12	.14	.50		
1880	3	.21	.63	.17		
1890	5	.51	2.71	.56		
1900	9	1.28	8.07	1.19		
1910	16	3.76	25.66	2.80		
1920	25	10.92	71.15	16.31		
1925	28	10.60	54.49	10.10		
1926	28	10.84	59.68	9.12		
1927	29	11.08	60.84	7.70		
1928	28	11.10	62.85	8.19		
1929	33	11.54	62.72	9.05		
1930	31	11.90	63.25	7.68		
1931	34	12.08	62.26	7.71		
1932	34	12.21	72.34	9.76		
1933	34	12.34	71.68	10.92		
1934	36	12.67	76.77	11.14		
1935	38	13.20	84.45	19.12	42.20	
1936	42	13.95	98.14	15.28	52.08	38.12
1937	39	12.78	100.26	16.82	55.07	37.60
1938	43	13.14	98.08	14.00	52.21	41.71
1939	51	13.56	100.73	16.72	57.86	38.95
1940	58	14.65	113.98	26.26	54.44	45.20
1941	63	16.19	137.64	25.69	68.95	61.57
1942	69	19.01	202.75	47.30	68.15	106.51
1943						
(A1)	57	23.67	319.65	76.57	108.93	167.02
(A2)	35	2.81	19.34	6.36	9.92	5.28
Total	92	26.48	338.99	82.93	118.85	172.30
1944						
(A1)	69	32.24	435.38	89.65	157.68	231.41
(A2)	49	4.68	39.96	15.77	17.10	10.67
Total	118	36.92	475.34	105.42	174.78	242.08
1945						
(A1)	75	38.75	541.15	105.59	220.91	278.52
(A2)	68	6.34	60.02	21.42	25.30	19.41
Total	143	45.09	601.17	127.01	246.21	297.93
1946						
(A1)	77	43.37	611.21	117.84	304.67	270.19
(A2)	58	6.67	62.72	18.27	30.29	23.24
Total	135	50.04	673.93	136.11	334.96	293.43
1947						
(A1)	80	46.57	619.87	125.76	284.13	284.85
(A2)	68	7.01	49.07	10.50	29.83	17.57
Total	148	53.58	668.94	136.26	313.96	302.42
1948						
(A1)	77	50.64	593.83	119.06	272.92	279.53
(A2)	72	7.38	46.13	8.08	28.87	16.98
Total	149	58.02	639.96	127.14	301.79	296.51

* From 1935 this includes the balance with the Reserve Bank of India.
A1 = Scheduled Banks ; A2 = Non-scheduled Banks.

PROGRESS OF INDIAN JOINT-STOCK BANKS EXCLUDING THE IMPERIAL OR STATE BANK, SINCE 1870—(*contd.*)
(*Figures in Crores of Rupees*)

Year	Number of banks	Capital and reserve	Deposits	Cash	Bills discounted and loans and advances	Investments in Govt. and other securities
1949						
(A1)	77	51.11	509.26	92.51	251.06	241.87
(A2)	78	8.35	45.99	7.62	31.70	15.53
1950						
(A1)	74	50.56	522.70	91.15	267.75	239.94
(A2)	73	8.90	46.59	6.51	26.60	21.93
1951						
(A1)	75	49.80	517.34	85.74	301.92	217.27
(A2)	70	8.36	44.26	6.00	27.47	19.82
1952						
(A1)	75	48.38	509.52	83.44	271.27	226.88
(A2)	70	9.01	38.82	5.84	24.84	17.67
1953						
(A1)	72	47.49	533.04	80.41	292.43	234.72
(A2)	67	8.85	41.16	6.12	25.61	18.07
1954						
(A1)	71	47.37	586.08	87.11	333.41	241.40
(A2)	65	8.83	45.15	6.57	27.19	19.55
1955						
(A1)						
Major	8	26.50	471.17	46.54	276.59	194.48
Other	63	20.84	197.10	26.52	114.36	74.00
(A2)	61	8.10	46.07	4.62	24.21	20.25
1956						
(A1)						
Major	8	27.13	514.39	47.77	341.15	187.56
Other	63	20.86	225.08	26.58	137.44	82.16
(A2)	58	7.96	50.95	4.75	27.23	23.06
1957						
(A1)						
Major	8	27.76	590.32	54.57	368.17	170.84
Other	65	24.09	283.42	32.56	156.43	98.24
(A2)	55	5.63	29.43	2.98	20.00	8.90
1958						
(A1)						
Major	8	28.74	654.62	55.67	386.74	284.55
Other	68	25.68	341.18	38.75	162.89	236.66
(A2)	42	4.39	21.08	2.00	14.39	6.36
1959						
(A1)						
Major	8	28.74	741.51	61.06	452.22	269.39
Other	69	26.03	398.71	43.68	224.37	155.19
(A2)	37	3.70	24.36	2.44	15.60	6.19
1960						
(A1)						
Major	8	29.71	765.53	68.44	540.55	224.18
Other	67	25.18	387.73	43.81	232.36	145.40
(A2)	36	3.49	24.15	2.30	14.44	7.49
1961						
(A1)						
Subsidiaries of State Bank	8	7.35	127.20	12.56	68.00	50.01
Other	58	49.60	1159.87	99.89	768.43	339.20
(A2)	32	3.08	21.74	2.25	13.28	6.38

Year	Number of banks	Capital and reserve	Deposits	Cash balances	Bills discounted and loans and advances	Investments in Govt. and other securities
Class B. Banks with capital and reserve between Rs. 1 & 5 lakhs.						
1913	23	.50	1.51	.25		
1915	25	.55	.91	.20		
1920	33	.81	2.33	.42		
1925	46	1.18	3.41	.67		
1926	47	1.26	3.47	.82		
1927	48	1.22	3.46	.52		
1928	46	1.20	3.50	.52		
1929	45	1.15	3.58	.45		
1930	54	1.37	4.31	.52		
1931	51	1.24	3.84	.47		
1932	52	1.29	3.93	.68		
1933	55	1.31	4.75	.82		
1934	69	1.49	5.11	.72		
1935	62	1.39	5.28	.82	4.59	
1936	71	1.47	5.46	1.00	4.74	.58
1937	108	2.17	8.29	1.33	7.46	1.03
1938	120	2.41	8.72	1.29	7.74	1.34
1939	119	2.32	9.27	1.37	8.85	2.14
1940	122	2.43	11.04	2.24	8.14	2.08
1941	125	2.56	11.45	2.67	8.38	2.75
1942	136	2.71	15.60	4.59	10.09	3.58
1943	152	3.17	20.90	6.69	12.53	4.76
1944	162	3.45	26.32	7.87	16.43	5.88
1945	174	3.61	32.05	9.50	18.45	8.25
1946	188	3.93	33.33	7.45	22.09	9.62
1947	185	3.87	27.51	5.44	19.86	7.66
1948	191	4.03	24.64	4.64	18.86	6.70
1949	190	4.05	20.56	3.41	16.50	5.87
1950	189	4.10	21.76	3.88	16.76	6.14
1951	186	3.96	20.79	4.24	15.94	5.06
1952	194	4.15	20.23	3.49	15.59	5.86
1953	196	3.99	19.11	3.26	14.10	5.94
1954	191	3.88	18.63	3.40	12.72	6.47
1955	183	3.66	19.77	2.25	12.77	6.62
1956	170	3.44	20.87	2.20	13.27	6.60
1957	163	3.32	20.48	2.20	13.13	6.26
1958	158	3.40	21.94	2.41	13.67	6.41
1959	147	3.46	21.88	2.29	13.86	6.21
1960	141	3.25	21.26	2.31	13.52	6.27
1961	121	2.67	16.78	1.82	10.49	4.90
1939	112	.77	2.98	.52	2.65	.42
1940	121	.84	2.86	.59	2.59	.44
1941	124	.90	3.93	.98	3.09	.65
1942	137	.97	4.95	1.56	3.40	.80
1943	141	.98	6.26	1.97	4.12	1.05
1944	113	.80	5.83	1.60	3.76	1.18
1945	114	.80	7.45	2.04	4.61	.53
1946	128	.85	5.19	1.10	4.19	.89
1947	121	.85	4.05	.77	3.53	.79
1948	120	.86	3.81	.66	3.50	.60
1949	124	.90	3.41	.61	3.23	.54

Year	Number of banks	Capital and reserve	Deposits	Cash balances	Bills discounted and loans and advances	Investments in Govt. and other securities
1950	123	.88	3.70	.81	3.05	.59
1951	117	.82	3.67	.76	3.16	.56
1952	114	.79	3.03	.66	2.67	.49
1953	114	.77	2.79	.59	2.38	.56
1954	116	.80	2.79	.57	2.26	.63
1955	97	.68	2.40	.30	1.84	.44
1956	93	.62	2.45	.29	1.90	.48
1957	74	.52	2.14	.72	1.53	.41
1958	73	.52	2.14	.72	1.53	.41
1959	75	.57	2.39	.30	1.64	.48
1960	66	.50	2.26	.34	1.52	.50
1961	56	.43	1.72	.24	1.18	.39
Class D. Banks having capital and reserve less than Rs. ½ lakh.						
1939	400	.76	2.63	.38	2.86	.23
1940	332	.60	2.71	.47	2.32	.25
1941	147	.26	.84	.13	.84	.07
1942	133	.23	.75	.13	.69	.06
1943	161	.29	1.59	.44	1.21	.14
1944	235	.46	3.49	1.04	2.47	.35
1945	244	.49	4.19	1.22	2.82	.50
1946	168	.33	2.79	.62	2.14	.41
1947	170	.36	2.69	.56	2.14	.29
1948	158	.34	1.97	.32	1.63	.27
1949	129	.29	1.59	.20	1.37	.16
1950	124	.29	1.31	.24	1.16	.14
1951	96	.23	1.05	.23	.87	.14
1952	60	.15	.68	.13	.56	.11
1953	54	.14	.48	.10	.42	.06
1954	37	.10	.26	.06	.24	.02
1955	25	.07	.23	.06	.29	.02
1956	12	.03	.07	.01	.07	.01
1957	4	.01	.04	.01	.03	—
1958	2	.01	.03	.01	.02	—
1959	2	.01	.03	.01	.02	—
1960	1	.01	.03	.01	.01	—
1961	—	—	—	—	—	—

tions. The Company pointed out that Act 47 passed during the reign of George III had given it the power to incorporate such banks, and that the Act limited the Royal prerogative to grant charters to them. The matter was not decided until 1853, and the only English bank to obtain the Royal Charter for operating in India until then was the Oriental Banking Corporation in 1842. The Presidency and Indian joint-stock banks, however, did not usually conduct exchange and remittance business between India and other countries as it was regarded risky, and the business was transacted by the agency houses.

By 1853 legal experts in England decided that Act 47 of George III empowered the Company to incorporate banks merely for transacting general banking business within its

territories, and that it did not limit the Royal prerogative to grant charters to banks for carrying on the business of exchange and remittances. Although the Company did not accept this interpretation, it regarded it unsound that the monopoly of the exchange business should be enjoyed by the Oriental Banking Corporation. It, therefore, suggested the incorporation of more banks, and so the Chartered Bank of India, Australia and China and the Chartered Bank of Asia (afterwards the Mercantile Bank of India, London and China) were brought into existence by Royal Charter in 1853. The failure of the agency houses also made the formation of such banks necessary.

The Oriental Bank failed in 1884; the Mercantile Bank had to abandon its Charter in 1893 and it was reorganized under the English Companies Act; so that the only English Bank that has continued to do business in India under a Royal Charter is the Chartered Bank of India, Australia and China. The National Bank of India was formed in 1863 under the name of the Calcutta Banking Corporation with its head office in Calcutta, but the name was altered to its present one in 1864, and its head office was transferred to London in 1886. Later on France, Germany, Holland, Portugal, Russia, the U.S.A., and Japan followed England's example, and opened branches of their banks, chiefly at the Indian ports. Three other English banks also opened branches in India. The Indian branches of the Deutsch-Asiatische Bank and the Russo-Asiatic Bank were closed on account of the War and have not been reopened. The Sumitomo Bank and the Imperial Bank of Persia closed their branches at Bombay in 1932 and 1934 respectively, on account of the economic depression. The Yokohama Specie Bank, the Mitsui Bank and the Bank of Taiwan were closed, when Japan went to war with Great Britain in 1941. In 1944, the banking business of Thomas Cook and Son was taken over by Grindlay & Co. Ltd. The Netherlands Indian Commercial Bank and the Banco Nacional Ultramarino closed their Indian offices in 1950 and 1952 respectively. The British Bank of the Middle East, the Bank of Tokyo and Mitsui Bank established their offices in India in 1950, 1952 and 1955 respectively.

The progress of these banks has been fairly rapid, and they form an important and powerful group at present. Their progress since 1870 is shown by the table on p. 20.[1]

1 See Statistical Tables relating to Banks in India.

5. *The Joint-Stock Banks as a whole.*—Out of 2,500 towns having a population of 5,000 and more, only 140 had each a banking office in 1916. The number increased to 339 in 1926 and to 514 in 1936. Applying the test of population, the geographical expansion of banking facilities appears to have taken place in a haphazard manner. Out of the towns inhabited by 20,000 people and more, 62 per cent. had a banking office in 1936. Out of the towns having a population between 10,000

Year	Number of Banks	Number of offices	Deposits in India in crores of Rs.	Cash balances in India in crores of Rs.	Advances and bills in India in crores of Rs.
1870	3		.52	.61	
1880	4		3.40	1.80	
1890	5		7.54	3.50	
1900	8		10.50	2.39	
1910	11		24.79	4.38	
1920	15		74.81	25.17	
1925	18		70.54	9.41	
1926	18		71.54	10.72	
1927	18		68.86	7.13	
1928	18		71.83	8.05	
1929	18		66.66	9.05	
1930	18		68.11	7.71	
1931	17		67.47	8.81	
1932	18		73.06	9.60	
1933	18		70.78	6.71	
1934	17		71.40	7.67	
1935	17	95	76.17	12.55*	31.30
1936	18	99	75.03	10.27	34.41
1937	18	97	73.20	10.58	36.94
1938	18	93	67.20	6.44	33.84
1939	19	99	74.17	6.88	50.15
1940	20	101	85.32	17.19	27.82
1941	17	99	106.73	13.39	31.43
1942	16	82	116.85	12.01	17.17
1943	16	84	140.19	17.24	30.12
1944	15	79	165.37	19.10	36.64
1945	15	77	179.00	18.32	45.82
1946	15	58	169.49	21.56	68.99
1947	15	60	163.67	27.18	91.43
1948	15	62	160.19	16.73	114.01
1949	15	64	161.38	18.87	121.11
1950	15	62	170.39	18.73	134.75
1951	15	62	167.99	24.25	173.81
1952	14	62	175.23	16.52	149.68
1953	14	64	164.70	14.41	130.41
1954	14	64	177.63	15.91	150.05
1955	15	64	195.61	16.44	167.51
1956	15	64	188.77	15.98	201.40
1957	15	64	205.63	18.41	157.94
1958	16	66	198.46	13.53	160.11
1959	16	66	228.80	16.97	171.09
1960	16	69	242.55	20.72	211.17
1961	15	71	263.61	21.96	229.68

*From 1935 this includes the balance with the Reserve Bank of India.

and 20,000 14 per cent. had a banking office, and out of the remaining towns, the same percentage had this facility in 1936. Although a considerable improvement took place in the extension of banking facilities to smaller towns during 1921-36, as shown by the fact that the percentage of towns with a population below 10,000 and possessing banking facilities nearly doubled itself during this period, mainly on account of the establishment of small banks, the absence of banking facilities in 38 per cent. of the towns, having a population of 20,000 and more, was striking.[1] The banking offices were fairly distributed in the Punjab, the U.P. and the three Presidencies, but banking facilities were very inadequate in other parts of India, especially Bihar and Orissa, the Central Provinces, Assam and most of the Indian States. The position of the Indian States in this respect would have been worse, if several of them had not assisted the Imperial Bank to open new branches within their territories.

The causes of this haphazard expansion were as follows: (1) Banking progress resulted from the initiative and enterprise of a few banking pioneers, who did not pay adequate attention to preliminary exploration and mapping out of banking potentialities. (2) The progress depended upon the competition of the exchange banks and the Imperial Bank. (3) British Indian banks showed a tendency to avoid Indian States in establishing branches, owing to fears of legal and administrative difficulties. (4) Many banking magnates showed a lack of initiative and planning. An enterprising or privileged bank established a branch in a town which had no banking facilities, and other banks followed and established branches in the same town indiscriminately. The 'Big Five' Indian banks established branches in most of the towns, in which the Imperial Bank had established branches. In 1936, two thirds of the towns, which had banking facilities, were dependent for them, entirely on the smaller Indian banks; these banks had to depend upon the smaller towns, while the bigger banks had offices mostly in the larger towns. The opinion that there is much scope for the extension of banking to smaller towns, *i.e.* that there are considerable banking potentialities in India, is supported by the fact that 60 per cent. of the branches of the Bank of Baroda, a well-managed bank, were in towns having a population of less than 20.000, and yet its liqui-

1 See Muranjan, *Modern Banking in India*, pp. 17-19.

dity and profitability were not less than those of any other of the 'Big Five.'[1]

The haphazard nature of the geographical expansion of banking has fortunately diminished much during the last few years. Between 1938 and 1945 the number of offices of scheduled banks increased from 1,128 to 2,933 and of non-scheduled banks with capital and reserves of Re.1 lakh and over, from 921 to 1,934. By 1948, the former increased to 3,024, but the latter declined to 1,767. But, by 1954· the former declined to 2,765 and the latter to 1,199. The former, outside the Indian Union, fell from 628 in 1946 to 97 in 1954 and the latter, from 183 in 1946 to 10 in 1954. By 1957, the former increased to 3,273 and the latter declined further to 947. By the same year, outside India, the former fell to 96 and the letter to 5. By 1961 in India the former increased to 439 and the latter declined still further to 629. By the same year, outside India, the former were 97 and the latter 2. Some of the Indian scheduled banks, however, have been very recently opening offices in the smaller towns also.

As regards the distribution of banking offices, in 1948, 44 per cent. or 2,335 offices were in 134 towns having a population of 50,000 or above, which worked out to an average of one banking office per 8,473 of their population; 56 per cent. or 2,942 offices were located in 1,400 places having a population of less than 50,000, which yielded an average of one banking office for every 6,143 of their population. Thus the ratio of offices to population was somewhat larger in the case of smaller towns than the larger ones. For all places served by a banking office, the average ratio was one office to every 7,219 of the population. For the Indian Union as a whole, the average ratio was one office for every 65,884 of the population. In 1954, 45 per cent. or 2,207 offices were in 175 towns having a population of 50,000 or above and 55 per cent. or 2,582 offices were located in 1,302 places having a population of less than 50,000. In 1957, 1,719 offices were in 80 towns having a population of 1 lakh or above, 1,443 offices in 302 towns, having a population of 25,000 or above, 2,261 offices in 1,244 towns having a population of less than 25,000 and 208 offices in 205 unclassified towns. In 1960, 1,926 offices were in 81 towns having a population of 1 lakh or above, 1,587 offices in 306 towns having a population of 25,000 or above, 2,587 offices in 1,312 towns having a population of less than 25,000

1 See Muranjan, *Modern Banking in India*, p. 20.

and 547 offices in unclassified towns making a total of 6,647 offices in 2,194 towns.

In 1948, about 53 per cent. of the offices of scheduled banks were in the larger towns and cities and about 67 per cent. of the offices of non-scheduled banks were in the smaller towns. This indicated the bias of scheduled banks in favour of the larger towns and cities. They had, however, a larger number of offices in the smaller towns than non-scheduled banks. Cooperative banks had about 63 per cent. of their offices in the smaller towns. In 1960, in towns having a population of 75,000 or less, scheduled banks had 1,638 offices out of their total of 4,149 offices, *i.e.* 40 per cent. non-scheduled banks had 609 out of 789, *i.e.*, 77 per cent. and co-operative banks 1,411 out of 1,710, *i.e.* 83 per cent.

Proceeding to branch expansion as a factor in the progress of banking in this country, it is found that the total number of branches of banks quadrupled itself between 1916 and 1936, and more than doubled itself betwen 1937 and 1945. Establishment of branches in towns, which previously possessed banking facilities, has been found easier than their establishment in towns, which lacked the facilities. During the first World War, the Presidency Banks hardly added to the 71 branches that they had at the outbreak of the War, but the Indian banks added 70. During 1921-28, the Imperial Bank established 100 new branches as required by the Imperial Bank Act, while the Indian banks established nearly 250. During 1929-33 the Imperial Bank laid down a policy of consolidation and established few new branches, but between 1934 and 1945 increased its branches from 202 to 433, while the Indian banks between 1929 and 1945 established nearly 2,000 new branches. The branches of the exchange banks increased from 45 in 1916 to 77 in 1926, 99 in 1936 and the number remained 99 in 1941, but fell to 84 in 1942 and 1943 and to 81 in 1945. The reason given by them for this quiescence is that their policy has been to desist from establishing new branches in the interior, unless their clients demand facilities for the kind of banking work in which they specialise. Between 1946 and 1948, the offices of the Imperial Bank, Exchange banks and Indian scheduled banks in the Indian Union increased from 358 to 367, 58 to 62 and 2,411 to 2,484 respectively, while those of the non-scheduled banks declined from 2,028 to 1,767. In 1954 the offices of the Imperial Bank, Exchange banks, Indian scheduled banks and non-scheduled banks in the

Indian Union were 455, 64, 2,242 and 1,199 respectively. In 1957 they were 622 (State Bank), 67, 2,584 and 947 respectively. In 1960 they were 901, 69, 3,179 and 789 respectively. It is noteworthy that nearly one-fourth of the banking offices in India belong to the smaller Indian banks, including the Co-operative Banks, and that nearly one-third of the towns which have banking facilities are dependent for these facilities upon them.

Between 1900 and 1914, the deposits of Presidency, Exchange and Indian banks increased by Rs. 57 crores and between 1914-22 by 107 crores. Allowing for the rise of prices, five-sevenths and half respectively of this growth was real. Even the small increase during 1922-29 showed that the banking system was increasing in strength, in spite of the depression and bank failures, because the price level was falling. By 1931 the price level fell to that of 1914, and the total deposits were Rs. 200 crores as compared with Rs. 87 crores in 1914. Between 1930-36, the deposits increased further by Rs. 45 crores. In 1941 they stood at Rs. 370 crores, increasing by Rs. 170 crores in a decade. Allowing for the rise of prices, however, this increase comes to a little more than Rs. 100 crores. By the end of 1947 the total deposits reached the peak of Rs.1,118 crores, but declined thereafter to 955 crores at the end of 1952 and increased to Rs. 1,480 crores at the end of 1957. In spite of this increase, between 1926-36 the deposits raised per town fell by 21 per cent. and per branch by 39 per cent. The reason is that the geographical and branch expansion of banking that has taken place in recent years, has brought the Indian banks into contact with poorer towns and clients. This tendency can be checked, if expansion is brought about systematically from towns with larger banking potentialities to those with smaller ones. The deposits of the exchange banks per branch rose from Rs. 75 lakhs in 1936 to Rs. 2 crores in 1945 and to Rs. 2.58 crores in 1948; those of the Imperial Bank per branch fell from Rs. 45 to 30 lakhs during 1936-41 but rose to Rs. 60 lakhs by 1945 and to Rs. 62 lakhs by 1948; those of the Indian banks fell from 1926 and stood at about Rs. 9 lakhs in 1941, but rose to Rs. 14 lakhs by 1943 and remained at that level in 1945 and 1948. The deposits of the Exchange banks, the State Bank and other Indian scheduled banks per branch in 1957 were Rs. 320, 59 and 25 lakhs respectively. In 1960, they were Rs. 350, 64 and 35 lakhs respectively. This disparity of resources per branch, combined

with ability to offer adequate services to the public, in competition with rivals, and yet to declare adequate dividends, shows that the banks either represent different types of organization or are engaged in different kinds of business, or both.[1] If the 'Big Five' are excluded, the resources of the other Indian banks come to about Rs. 6 lakhs only per branch. Nevertheless, nearly one-half of the towns that have banking facilities are dependent upon these banks for the facilities, and nearly one-third of the banking offices in the country belong to them.

The Indian banking system has displayed much concentration regarding the deposit resources of the country, and yet much diffusion and regionalization regarding the provision and expansion of banking facilities. The concentration is shown by the fact that in 1941 the Imperial Bank, 16 Exchange banks and the Big Five Indian banks held 83 percent. of the total banking deposits of the country and that the Big Five held 67 percent. and the Big Seven, 71 per cent. of the total deposits held by Indian banks. In 1943, however, the percentages fell to 78, 57 and 61 respectively. The following forces have helped the concentration:—(1) Cautious and prudent directors and manager of a bank know that, as its resources are withdrawable on demand, they must not allow it to depend unduly on a particular market or a group of allied markets, whose stagnation or collapse may create serious difficulties for the bank. They, therefore, endeavour to build up connections with a wide variety of commercial lines. This policy, if successful entails large resources, wide clientele and the utilization of new areas. (2) Apprehensions roused by the expansion and competition of the Imperial Bank, with its increasing branches, have led a few banks to expand themselves by establishing more branches, or by amalgamations, or both. This seems to have been expecially true of the Central Bank of India. (3) Differences of interest rates in different parts of India have induced some of the banks to expand themselves into the areas of the higher rates, *viz.* Madras, the Punjab and the United Provinces. The strength of the above forces is, however, now tending to diminish. This is shown by the fact that in 1945 the Imperial Bank, 15 Exchange banks and the Big Nine Indian banks held only 73 per cent. of the total banking deposits of the country and that the 'Big Nine' held only 55 per cent. of the total deposits held by Indian banks. At the end of 1957 the State Bank,

1 See Muranjan, *Modern Banking in India*. p. 25.

15 Exchange banks and the 'Big Eight' Indian Banks held 78 per cent. of the total banking deposits. At the end of 1960, the percentage was the same.

The diffusion and regionalization are shown by the fact, mentioned above, that nearly two-thirds of the towns that have banking facilities are dependent upon small local banks for the facilities. Some of the big banks even have acquired a strongly regional aspect. A large part of the operations of the Banks of Baroda and Mysore is within their respective States, and of the Indian Bank within Madras. The Bank of India restricts its operations mainly to the industrial and commercial towns of the Bombay Province. Only the Imperial Bank and the Central Bank of India have been operating in most parts of India, the former on account of the privileges conferred, and the compulsion imposed, by the Imperial Bank Act, the latter on account of a spirit of enterprise.[1]

The following forces have promoted the diffusion and regionalization:—(1) A bank, with numerous branches, which must be subjected to detailed regulations from the head office, and which, therefore, must observe strictly formal procedure, cannot provide the personal contacts and the informal procedure, which are greatly valued by a large section of the Indian business community. Only local banks can provide them. (2) Amalgamation, which has been mainly responsible for the concentration of banking in other countries, is difficult in India, because many banks have been established to safeguard and promote different and conflicting communal, sectional and family interests. (3) As mentioned before, British Indian banks were unwilling to establish branches in Indian States. For the same reason, a bank belonging to one Indian State is unwilling to establish branches in other States. The result was different local banks for different States.

In spite of the progress made by the Indian banking system in recent years, it is still in a backward condition. This is shown by the facts that in 1948 bank deposits per head of population were only a pound sterling, out of the 2,100 only 1,534 had each a bank or a branch of a bank, and the total number of banking offices was 5,277. This meant a banking office for every 85,884 persons in the Indian Union as against 3,056, 4,816 and 9,491 persons in the U.S.A., Great Britain and Japan respecti-

1 See Muranjan, *Modern Banking in India*, pp. 32-33.

vely. The banking offices in the Indian Union were distributed at the end of 1957 and 1961 as follows :

Offices

	1957	1961
State Bank	622	946
Exchange Banks	67	71
Other Indian Scheduled Banks	2,584	3,376
Non-Scheduled Banks	947	629
Co-operative Banks with capital and reserve of Rs. 1 lakh and above.	1,421	1,940
	5,641 in 1831 places	6,962 in 2373 places.

This meant a banking office for every 66,071 and 63,090 persons in India in 1957 and 1961 respectively.

If the fact, that the vast bulk of the people live in villages and not in towns, is taken into account, the absence of banking facilities to the people at large in India becomes more striking.

6. *Banking Inquiry*.— Dissatisfaction with the progress of banking in India led to a demand for a comprehensive inquiry into the needs of banking in India from different quarters for a long time. At last in 1929 the Government of India, after consulting the Central Legislature and the Provincial Governments, organized a comprehensive banking inquiry in three stages. In the first stage, ten Provincial Committees, composed of persons having intimate knowledge of local conditions, dealt with agricultural and co-operative credit, mortgage banks, credit for small industries, the finance of internal trade, encouragement to the habit of investment, and increase of banking deposits, and issued reports. Nineteen of the Indian States appointed similar Committees for their own territories. In the second stage, an All-India Committee co-ordinated the work of the above Committees, and itself examined the aspects of banking which had been excluded from the scrutiny of the Committees, *viz*. credit for India's chief industries, banking regulation, and banking education. In the third and final stage, after it had finished its investigations, the Central Committee was helped to form conclusions and to make recommendations by a Committee of six foreign banking experts

selected by Government, from England, Scotland, Canada, Germany, Holland and Denmark. The Provincial Committees issued their reports in 1930, and the Central Committee in 1931, a majority report including the foreign experts' report, and a minority report signed by one member only, Mr. Manu Subhedar, who had been appointed on the Committee as an Indian economist. The reports and the volumes of evidence contain an enormous wealth of information and many important suggestions for quickening and improving the progress of banking in India.

7. *The Progress of Banking since the Second World War.*—During 1939-41, the progress of banking was small. But during 1942-46, the progress, as judged by the increase in the number of banks and of their branches and in their deposits, was very rapid. The number of Scheduled Banks, including the Imperial Bank and the Exchange Banks, increased from 51 in June, 1939 to 93 in June, 1946 and the total number of their offices, including head offices, from 1,328 to 3,106. Their deposits rose from Rs. 238 crores at the commencement of the War to Rs. 1,097 crores at the end of 1946. They had increased by Rs. 20 crores only during the three years ending in March 1939. In spite of this rapid growth and some defects, which will be mentioned later, the banking system, as a whole, became stronger during this period. The ease with which it adjusted its operations to the exigencies of war finance was surprising. It helped the Government to finance the War on the basis of 3 per cent. interest and to keep the inflationary forces in check by helping to finance huge loans, thereby mopping up redundant funds.

With the return of peace, the banking system readjusted itself to peace conditions with equal ease. But it was not left in peace for long. The disturbances that occurred in several parts of the country for some months before and after the Partition of the country and the policy pursued by the Government of Pakistan imposed a severe strain upon it. But, excepting a surprisingly small number of casualties, it came out of this ordeal without much harm. This ordeal and the serious economic difficulties through which India passed after the achievement of independence, however, temporarily held up its further progress and it had to pass through a period of consolidation. There is no doubt that it could not have passed through these changing times, with the comparative ease and success, which characterised

its operations, without the competent guidance and supervision of the Reserve Bank of India. Since 1954, it has resumed its progress. During 1942-48, its progress was mainly quantitative, while from 1949, the quality of its working improved appreciably.

The reasons for the rapid expansion of commercial banking during 1942-46 were that the banking was in the early stages of its growth and had, therefore, large scope for expansion and that expansion of currency, resulting from war finance, made enormous funds available for investment. These funds could not be used for establishing industrial concerns, on account of the great difficulty of obtaining machinery and industrial equipment. But there was no such difficulty in the way of establishing new banks. The largest among the new banks, established during this period, were the United Commercial Bank, Calcutta and the Bharat Bank, Delhi, sponsored by the houses of Birla and Dalmia respectively. Of the 1,778 new banking offices established during this period, only 47 belonged to the Imperial Bank, one-third to the Big Nine and a little less than two-thirds to the smaller Indian Scheduled Banks, which had only one-third of the deposits of the Indian banks. The result of this was that, in spite of the enormous increase in total bank deposits, the volume of resources of the smaller Scheduled Banks did not exceed Rs. 5 lakhs per branch, in most cases, and that the resources increased from Rs. 20 to 35 lakhs per branch in the case of the bigger banks only. During 1939-46 the number of non-scheduled banks having paid-up capital and reserves of Rs. 5 lakhs and over, between Rs. 1 and 5 lakhs and between Rs. 50,000 and 1 lakh increased from 12 to 75, 119 to 214 and 112 to 140 respectively.

This expansion was accompanied by a change in the proportions of the total deposits held by the different categories of banks. Between 1941 and 1945, of the total deposits, the percentage held by the Exchange Banks fell from 29 to 17, that held by the Imperial Bank fell from 31 to 24, while that held by Indian banks increased from 40 to 59 per cent. Between 1938 and 1945, the deposits of the Exchange Banks, Imperial Bank, other Scheduled Banks and Non-Scheduled Banks increased by 167, 220, 515 and 320 per cent. respectively. The total deposits increased by Rs. 212, 161, 134 and 116 crores at the end of 1943, 1944, 1945 and 1946 as compared with their

amount at the end of the previous year. The increase in deposits was largely the result of the expansion of currency, due to the expenditure by the Government of India, on its own behalf and on behalf of the Allied Governments, for the prosecution of the War, but it was also partly the result of the tapping of new deposits by banks. In countries like Britiain, the U.S.A., Canada and Australia, in which the cheque habit has been greatly developed, the expansion of bank deposits was much greater than that of currency. But in countries like India, where the habit is still in its infancy, the former was much less than the latter. Thus, between September 1939 and the end of 1946, while the bank deposits in India increased by Rs. 756 crores, the notes in circulation increased by Rs. 1,014 crores.

Moreover, a notable change took place in the character and rate of turnover of the deposits. Between 1939 and 1944, the proportion of fixed deposits to total deposits fell from one-half to less than one-fourth, as they increased far less in amount than current deposits. The first reason for this change was that the war strengthened the tendency which had come into existence during the preceding Depression, namely, low rates of interest for fixed deposits weakening the public desire to hold them and strengthening its desire to hold liquid assets in the form of current deposits. Secondly, the public was not willing to convert its savings into durable assets, such as gold, shares and real estate on account of their inflated prices and held the savings in the most liquid form, so as to be able to purchase durable assets, as soon as their prices went down, fondly hoping that this would happen soon after the cessation of hostilities. Finally, on account of the difficulty of obtaining industrial equipment during war-time, the savings could not be used for the creation or extension of industrial establishments and had to be used as larger working capital, for obtaining larger output from the existing scale of equipment in establishments. The first two reasons also slowed down the rate of turnover of the deposits.

As a result of the phenomenal expansion of deposits, between 1939 and 1945, the percentage of the paid-up capital and published reserves to bank deposits fell from 12.8 to 4.5, 10.8 to 7 and 9.3 to 5 in the case of the Imperial Bank, the Indian Scheduled Banks as a whole and the Big Five Indian banks respectively. Between 1939 and 1945, the paid-up capital and reserves of the Imperial Bank and the Indian Scheduled Banks increa-

sed from Rs. 24 to 53 crores only, but their deposits increased by Rs. 622 crores. As regards the safety of depositors, this unfavourable factor was neutralized only in part by the higher percentage of liquid assets, which banks had to keep on account of war conditions. The pre-war percentage of capital and reserves to deposits varied between 10 and 8, according to the form in which banks kept their assets, being less in the case of banks, which kept the bulk of their assets in a liquid form. Consequently, with the sanction of Government, some banks increased their capital.

War conditions brought about a change also in the structure of the assets of banks. Although, during the greater part of the War, the value of bills and advances of the Scheduled Banks was somewhat larger than the pre-war value of Rs. 112 crores, their growth was much smaller than that of the other assets of the banks. Between the end of 1939 and 1944, the percentage of the bills and advances of the Scheduled Banks to their total assets fell from 62 to 25; in the case of the Imperial Bank, the percentage fell from 55 to 20; and in the case of the Big Five, from 53 to 30. The reasons for the fall were the smaller dependence of businessmen on bank finance, owing to larger profits made by them and used by them as workng capital, and advance payments obtained by them, as contractors and producers, from Government, fall in the import and export trade on private account, restrictions on the internal movements of commodities, restrictions on advances against goods and unfavourable effects of the War on certain markets, such as jute and cotton.

The large fall in the percentage of bills and advances to total assets compelled banks to increase substantially their holdings in Government and other securities. Government also wanted the banks to subscribe as much as possible to its enormous War loans. Between the end of 1938 and 1944, the percentage of the holdings to total assets increased from 54 to 61 and from 43 to 51 in the case of the Imperial Bank and the other Indian Scheduled Banks respectively. But these increases counterbalanced the fall in the percentage of bills and advances only in part. Hence, the percentage of cash to liabilities of the Imperial Bank and of the other Banks increased from 11 to 25 and from 15 to 24 respectively.

Easy money conditions prevailed until the end of 1946. Hence, only a small number of banks, not more than a dozen

in any year, needed financial accommodation from the Reserve Bank, and the total accommodation granted to them in a year varied between Rs. 1 and 4 crores.

More liquid and, therefore, less profitable assets, bearing a much higher proportion to the total assets of banks, meant less profits for them. But this factor was more than counterbalanced by a lowering of the interest paid by them on deposits. Hence, their profits increased and some of them had even to pay the Excess Profits Tax.

New as well as old banks experienced a considerable shortage of trained employees on account of the rapid expansion of banking.

Although the progress of banking was rapid and substantial during the War, it was not free from defects. The principal defects were opening of banking offices in areas far away from the main field of banks' activities, indiscriminate branch expansion, opening of branches in centres already well served, unhealthy and wasteful competition among too many banking offices in some parts and centres, but no offices in some other parts and centres, acquisition of the control of non-banking companies, interlocking of banks and other concerns, undesirable manipulation of accounts and the utilization of profits resulting from the rise in the market prices of Government securities for paying dividends instead of building reserves. The number of banks, which went into liquidation or were wound up, was 90, 102, 77, 49, 51, 22, 26 and 27 in 1939, 1940, 1941, 1942, 1943, 1944, 1945 and 1946 respectively. Most of them were very small non-scheduled banks. Moreover, the number of failures declined considerbly during the peak years of the War.

Soon after the cessation of hostilities, the structure of the assets and liabilities of banks began to come back to the prewar pattern and this process went on until about the middle of 1947. The proportion of fixed deposits to total deposits, which had fallen to one-fourth in 1944, rose to one-third, on account of the return of confidence among the public and the consequent disappearance of preference for liquidity. This was a healthy development, as it imparted greater stability to the resources of the banking system and rendered it less vulnerable. The turnover of the deposits also became quicker.

Advances and bills almost resumed their pre-war place in the assets of the Scheduled Banks. In a single year, from the end of 1945 to the end of 1946, they increased from Rs. 327 crores to Rs. 447 crores. Hence, their percentage to total deposits increased from 34 to 42 per cent. in spite of a large increase in deposits, their pre-war percentage being 45. The reasons for the increase were rise in prices, particularly of industrial raw materials and imported goods, revived and seasonal trade activity, resulting from the curtailment of Government business activity, resumption of private imports and exports, increased facilities granted by banks against securities, shares, bullion and commodities, immobilisation of funds in commodities on account of the shortage of wagons and transport, credit granted by banks for the purchase of surplus war stores from Government valued at several crores of rupees, and heavy tax payments by businessmen. In spite of the further development of Government cheap money policy, the rates charged by the banks were slightly higher than those in the two previous years.

On the other hand, the percentage of the investments of the Scheduled Banks fell from 53 at the end of 1945 to 46 at the end of 1946. The percentage of cash also to the liabilities of banks fell during this period. The general result was that this period proved to be more prosperous to banks than even the war period, and their profits were higher. Towards the end of 1946, however, a minor banking crisis developed in Bengal, owing to the suspension of payments by a number of non-scheduled banks, which had indulged in indiscriminate branch expansion, unwise trading and the grant of excessive facilities, against shares. Fortunately, the crisis was minor and local.

During the latter half of 1947 and the early months of 1948, the structure of the assets and liabilities of banks tended to resume the war-time pattern, the proportion of investments and cash to total assets increasing and that of advances and bills diminishing. The advances and bills of Scheduled Banks, which had increased from Rs. 452 to 492 crores during the first quarter of 1947 reached their lowest level at Rs. 412 crores in October. The chief reason for this change was the communal tension and disturbances in several parts of the country, before and after its partition, with serious dislocation and shrinkage

of agricultural and industrial production and of internal and foreign trade, and destruction of goods and other forms of property valued at many crores of rupees. The banks were therefore, compelled to curtail the grant of credit and to increase their investments and especially their cash, as a precautionary measure for meeting any emergency that might arise.

Before the partition, banking was conducted mostly by Hindus, even in those parts of the country, which were predominantly inhabited by Muslims. The clients of the banks were also mostly Hindus. Anticipating disturbed conditions, most of the banks in the Punjab, run by Hindus, led by the Punjab National Bank, which had many offices in West Punjab, transferred their head offices from the threatened area of West Punjab to the safer areas of East Punjab and Delhi, even before the partition, and reduced their commitments in the former by recalling advances. But banks could not curtail these commitments beyond a certain extent. Hence, when serious disturbances occurred, as soon as partition was effected, most of the banks suffered considerable losses in West Punjab and had to close down their offices there, on account of the lack of security and the evacuation of their Hindu staff. Only the Exchange Banks could function in that area, with considerable difficulty, owing to the shortage of staff.

The Government of India, with the help of the Reserve Bank, took prompt steps to localise the crisis among the Punjab banks and to give help to those which required it. Section 17 of the Reserve Bank Act, which had considerably restricted the power of the Reserve Bank to make advances to Scheduled Banks, was modified, so as to empower the Reserve Bank to make advances to them on any security, which it thought proper. Next, the East Punjab and Delhi Banking Ordinance was promulgated, empowering Government to make an order staying for three months the commencement or continuance of all proceedings against a bank, having its head office in East Punjab or Delhi. During the period of the moratorium, a bank had to make payments to depositors not exceeding 10 per cent. of their current deposits in India or Rs. 250, whichever amount was less. Further, Government made Rupees One Crore available for rehabilitating the affected banks. These measures became necessary because, while some of the banks had taken

the precaution of removing the bulk of their assets from West Punjab, before the commencement of the disturbances, others had not done so and found that, although their assets had remained in West Punjab, their clients had transferred themselves from West to East Punjab and demanded their deposits back in the latter area.

These happenings were accompanied by a depression in the share and security markets, which led to the failure of a few of the weakest units of the banking system, numbering 30 in 1947. Most of them were non-scheduled banks and their difficulties were due to the absence of trained personnel, mismanagement, indiscriminate opening of too many small branches, reckless lending and speculation on the stock exchanges. A few of the Scheduled Banks even got into difficulties for the same reasons, but most of them survived on account of the help given by the Reserve Bank, and appearance of a sense of responsibility amongst those who managed them, before it was too late. One prominent Scheduled Bank however, failed and two others had to be prevented from accepting fresh deposite. The powers given to the Reserve Bank for the inspection of banks by the Banking Companies (Inspection) Ordinance 1946, proved salutary, as they enabled the Reserve Bank to bring about the liquidation of those banks, which were beyond recovery, and to redeem others by timely help and advice. The Reserve Bank maintained a close watch over the banking system. This, combined with the policy of caution enforced upon bank managements by the serious political and economic developments since Partition, has, on the whole, checked the unhealthy tendencies that were noticeable in the banking system during 1945 and 1946, and has brought about a qualitative improvement in the system. The quantitative expansion of Indian banking was checked by the passage of the Banking Companies (Restriction of Branches) Act at the end of 1946, the provisions of which were later included in the Banking Companies Act, 1949. It prohibits every bank from opening a new branch or changing the location of an existing branch, except in the same city or town, without the previous permission of the Reserve Bank. But for this legislation, new branches would have been indiscriminately opened.

The deposits of banks at the end of 1947 were only Rs. 10 crores more than those at the end of 1946 and those at the end

of 1948 were Rs. 11 crores less than those at the end of 1947, as against the annual increases in the previous four years rangeing between Rs. 212 and 116 crores. This serious decline was due to the disappearance of Government war expenditure, fall in savings owing to fall in production, increase in unemployment, increase in taxation, rise in the cost of living and transfer of capital from India to Britain for reasons of safety. But, whereas in 1947 the fixed deposits recorded an increase and current deposits fell, in 1948 the trend was in the opposite direction, owing to a revival of liquidity preference brought about by a lack of confidence in the future, a desire to keep one's funds ready, so that they would be available, whenever an opportunity for expanding one's business became available and a sharp rise in the cost of living unaccompanied by a corresponding rise in income, involving the need to draw on past savings, which had been formerly kept in the form of fixed deposits.

During 1948, the advances and bills of banks underwent a marked expansion. Their combined value was Rs. 36 crores higher at the end of 1948 than at the end of 1947. This was due to the sharp rise in the price level, which necessitated a larger volume of money for financing even a reduced supply of goods, and a marked increase in the volume as well as value of imported goods. Although most of the banks did not charge a higher rate of interest, the higher level of advances and bills as well as a fall in the fixed deposits, on which higher interest had to be paid than on current deposits, enabled many of the banks to secure higher net profits, in spite of an increase in their establishment expenses, resulting from the payment of higher emoluments to their employees. Sir Chintaman Deshmukh, in a speech admitted that banks generally had refrained from undue expansion of credit, but said that some appeared to have shown progress at the cost of relaxing the accepted standards of banking practice in making advances, possibly out of a desire to meet the enhanced cost of management and to maintain dividend levels.

The expansionist trend in Indian banking, which had been set in motion by the War in 1942 and which had continued up to 1948, came to an end in 1949. From this year upto 1953 there was a contraction in the deposits and profits of banks, which, therefore, had to direct their energies primarily to the

consolidation of their position. The number of Scheduled Banks declined from 96 at the end of 1948 to 89 at the end of 1953, owing to the failure of four and demotion of three others. Owing to a sharp increase in the cost of operations, combined with a fall in business, several banks, especially those which had sprung up during the War and had extended their activities rapidly, had to close some of their branches, as a measure of economy. But the position of commercial banks, as a whole, has improved on the qualitative side. The Reserve Bank has maintained a close watch on the banking system and it can do so more effectively since March 1949, when the Banking Companies Act was passed, to strengthen the powers of the Reserve Bank for this purpose. Moreover, the banks themselves have been following a more cautious policy in respect of their advances.

The total deposits of scheduled and non-scheduled banks at the end of 1948, 1949, 1950, 1951, 1952 and 1953 were Rs. 1118, 997, 1002, 988, 955 and 969 crores respectively. The contraction of deposits was due to rising costs of production and living, high taxation, fall in the earnings of companies and firms, shrinkage in the capacity of the higher and upper middle classes to save, drawings upon past savings by the middle classes and evacuees from Pakistan, shift of the saving capacity to the lower classes, who had not formed the banking habit, repatriation of foreign capital, nervousness in the minds of the depositors of some banks created by rumours, and contraction in the volume of currency, caused by heavy inroads upon the country's foreign exchange resources brought about by continued deficits in India's balance of trade. But although the resources of banks fell, the demand for bank accommodation remained keen, the total advances and bills of scheduled and non-scheduled banks at the end of 1948, 1949, 1950, 1951, 1952 and 1953 being Rs. 543, 518, 553, 666, 578 and 564 crores respectively. The main reasons for this were large expansion in imports, the speeding up, by Government, of income-tax collections through provisional assessments, hoarding of large stocks of raw materials by manufacturers, in the fear of scarcity of supplies, and of finished goods by manufacturers and merchants, in the hope of obtaining better prices, heavy accumulation of stocks of cloth with the mills, at first owing to shortage of transport, and later owing to inefficient control, and exceptional congestion

of goods in the ports owing to want of transport. Consequently, there was stringency in the money market and to meet the heavy demands for funds, Scheduled Banks had to sell off their investments in Government Securities to an appreciable extent. Most of this amount was taken up by the Reserve Bank of India. Moreover those banks, which had a large proportion of investments in long-dated Government Securities, changed over to a large extent to medium and short-dated ones, particularly the latter, on the advice of the Reserve Bank. The sale of Government securities indicated that there was no dominance of investments over the assets of banks, which returned again to the pre-War pattern.

Between 1948 and 1953, the number of Indian scheduled and non-scheduled banks fell from 78 to 72 and from 544 to 432 respectively and the total number of offices of all scheduled and non-scheduled banks in the Indian Union fell from 4,674 to 3,943, while the number of their offices outside the Indian Union fell from 272 to 106. The number of banks which went into liquidation or otherwise ceased to function was 45, 55, 45, 60, 31, 31 and 27 in 1948, 1949, 1950, 1951, 1952, 1953 and 1954 respectively.

The earnings of banks went on increasing during the above period, the earnings of Indian scheduled banks for 1946, 1947, 1948, 1949, 1950, 1951, 1952 and 1953 being Rs. 27.26. 29.83, 29.73, 29.62, 29.10, 32.28, 34.38 and 34.34 crores respectively. But their expenses also increased largely on account of the awards of Industrial Tribunals and to a less extent on account of the necessity of paying higher rates of interest on deposits, the expenses of Indian scheduled banks for the above years being Rs. 17.90, 20.64, 21.66, 21.74, 22.52, 24.77, 26.94 and 27.82 crores respectively. Consequently, their net profits fell, the net profits of Indian scheduled banks for the above years being Rs. 9.36, 9.19, 8.07, 7.88, 6.58, 7.51, 7.44 and 6.52 crores respectively.

The banks resumed their progress from 1954. The total deposits and total advances and bills of all banks at the end of 1957 had increased to Rs.1,480 and 829 crores respectively. The increase in deposits was due to: (1) increase in money incomes of people brought about by Government disbursemens in connection with the Five Year Plans, (2) hardening of

interest rates, (3) increase in the number of offices of banks, (4) tight import restrictions, which induced business concerns and other bodies to seek temporary investment of their reserves and other surplus funds in the form of time deposits, and (5) keeping with the State Bank of India and certain Exchange Banks of counterpart funds of the American wheat loan to India under P.L. 480. The profits of Indian scheduled banks, before deduction of taxes, for this year amounted to Rs. 12.5 crores, their earnings and expenses being Rs.62 and Rs.49.5 crores respectively. The total number of offices of scheduled banks in the Indian Union increased by 340 between 1954 and 1957. The smaller banks, however, continued to feel the strain of the period 1949-53 and the number of non-scheduled banks and of their offices in the Indian Union fell further by 112 and 252 respectively between 1954 and 1957. The number of banks which ceased to function was 29, 19 and 25 in 1955, 1956 and 1957 respectively. It was therefore, suggested that amalgamation and consolidation would be in their own interests. In March 1950 certain sections were added to the Banking Companies Act, in order to facilitate amalgamations. On account of the difficulties created by the political conditions in Pakistan, non-devaluation of its rupee and the failure of the Nath Bank, the Comilla Banking Corporation, the Comilla Union Bank, the Bengal Central Bank and the Hooghly Bank, having the bulk of their operations in Bengal, amalgamated in December 1950, with the help of the Reserve Bank of India, and formed the United Bank of India.

In March 1951, the amalgamation of the Bharat Bank with the Punjab National Bank resulted from the Reserve Bank inspection. The inspection showed that the methods of working of the former and particularly its policy regarding the granting of advances, left much to be desired. These defects were brought to the notice of the directors. Under the scheme of merger, the Punjab National Bank took over the liabilities of the Bharat Bank in respect of deposits in the Indian Union against the transfer of equivalent assets. In August 1958, the Hind Bank Ltd. was amalgamated with the Bank of Baroda Ltd.

But the earlier proposals to amalgamate the Union Bank and the Hind Bank and to amalgamate the Bank of Bikaner, the Bank of Jaipur and the Bank of Rajasthan fell through. This shows that voluntary amalgamation of banks is a very difficult matter. It

is felt that it is not in the interests of sound, well-run and firmly established banks, their clients and the areas which they serve and in the general interests of the country, that they should lose their separate existence, although they have been rendering useful services in their respective spheres. The smaller banks play an important part in the economy of the country. They cater to a class of people, whom the larger banks do not serve. As the people, especially in semi-rural areas, have been long accustomed to personal contacts, a small number of large banks will not be found in practice as popular among them as the existing smaller banks and is likely to retard the extension of banking facilities to rural areas, that is now regarded very desirable by Government and all other interests. Moreover, each bank has its own policies, traditions, characteristics and methods, and clashes in them, in the case of amalgamation of banks, would often be unavoidable and detrimental to all concerned. The best solution of the difficulty, therefore, appeared to be that all commercial banks should agree to charge reasonable rates for different kinds of banking business, avoiding undercutting in any form. At the end of 1958, all large and medium sized and some smaller banks voluntarily entered into an agreement which fixed ceilings on the rates of interest which they could pay on different kinds of deposits.

But in 1960, the failure of two scheduled banks, namely Palai Central Bank and Laxmi Bank, led to a certain amount of loss of public confidence in the banking system as a whole. The Government of India, therefore, felt it necessary to give the Reserve Bank powers to formulate and carry out, with the sanction of Government, schemes for the reconstitution and compulsory amalgamation of sub-standard banks with well-managed banks. The Banking Companies (Amendment) Act 1961, gave the Reserve Bank these powers. Any amlgamation proposed under this Act is binding not only on the concerned banking companies, their members and creditors, but also on their employees and other persons possessing any right or liability in relation to such banking companies.

The Central Government, on the application of the Reserve Bank, granted moratoria to 39 banks having deposits amounting to Rs. 19 crores, for a few months, during which they were not permitted to make any payment to any depositor or discharge any liability to other creditors, except as provided in the mora-

torium orders. For minimising hardship to the depositors, the moratorium orders allowed the banks to make limited payments to their depositors during the period of moratorium. Out of the above 39 banks, 30 were amalgamated with other banks. Government lifted the moratoria in respect of 2 banks on the guarantee of their directors to make payments to the depositors from their personal assets, if necessary. The remaining 6 banks were taken into liquidation.

The general pattern of the scheme of amalgamation is that the transferee bank pays outside liabilities such as taxes, salaries payable to the staff in full, pays each depositor either his balance or Rs. 250, whichever is less, and in addition an amount in proportion to the value of the assets of the transferor bank, considered as readily realizable. As and when the remaining assets are realized further payments are made. If the assets are insufficient to pay the depositors and other outside liabilities, the uncalled share capital of the transferor bank is called up. The surplus, if any, left after meeting the above claims in full, is disbursed among the shareholders.

The deposits of all banks, scheduled and non-scheduled rose by Rs. 222, 280 and 20 crores in 1958, 1959 and 1960 respectively and reached Rs. 2001 by the end of 1960. The large increase in 1958 and 1959 was due to the first and third of the five reasons mentioned above. The small increase in 1960 was due to (1) smaller order of deficit financing, (2) adverse effects of the closure of two scheduled banks on public confidence, (3) offer of higher rates of interest by some industrial companies to attract deposits direct from the public, (4) direct financing on a cash basis of some transactions on the market by some depositors at higher rates of interest, and (5) deposit of fresh P. L. 480 funds with the Reserve Bank of India and transfer of the previous deposits of these funds from the State Bank of India to the Reserve Bank of India at the rate of Rs. 12 crores per month. However, the upward trend in deposits recovered particularly during 1961. They amounted to Rs. 2089 crores at the end of the year, showing an increase of Rs. 88 crores.

The demand deposits fell by Rs. 10 crores in 1958 and rose by Rs. 19 and 51 crores in 1959 and 1960 respectively. The time deposits rose by Rs. 225 and 234 crores in 1958 and 1959 respectively and fell by Rs. 12 crores in 1960. Between 1957 and 1959, while the demand deposits increased by Rs. 65 crores only, the time

deposits increased by Rs. 649 crores, so that while in 1956 the time deposits were 25 per cent. less than the demand deposits, by 1959 they were 60 per cent. more than the latter. This spectacular increase in time deposits was due largely to the growth of the saving and banking habit among the lower and middle income groups of people accompanied by an appreciable increase in their income resulting from the expenditure on the Second Five-Year Plan and partly to the P. L. 480 deposits. The small fall in the time deposits in 1960 was due to the reasons mentioned in the previous paragraph. In this year, the postal savings deposits showed a steep rise indicating that many persons perferred the postal savings banks to the commercial banks for keeping their time deposits. In 1961, the demand and time deposits increased by Rs. 55 and 33 crores respectively.

The advances of banks increased by Rs. 11, 91, 208 and 75 crores in 1958, 1959, 1960 and 1961 respectively and amounted to Rs.1,141 crores at the end of 1961. The advance-deposit ratio increased from 52.2 per cent in 1959 to 64.4 per cent in 1961. The steep increase in 1960 was due to a substantial rise in the rate of growth of industrial output and in investment activity in the economy rise in prices, especially of industrial raw materials and manufactures, and some speculative activity on the stock and commodity markets. The profits of Indian scheduled banks, before deduction of taxes, were Rs. 10.50, 13.67, 17.44 and 23.50 crores in 1958, 1959, 1960 and 1961 respectively. Their total earnings were Rs. 72.35, 83.82, 92.73 and 103.58 crores and their total expenses Rs. 61.85, 70.15, 75.28 and 80.09 crores during 1958, 1959, 1960 and 1961 respectively. The total number of offices of scheduled banks in the Indian Union increased by 1,120 between 1957 and 1961. The number of non-schedued banks and their offices, however, fell further by 39 and 318 respectively between 1957 and 1961. The number of banks which ceased to function was 29, 33, 27 and 53 in 1958, 1959, 1960 and 1961 respectively

Growth in deposits during 1951-60.—During the five years 1951-55, which corresponded roughly to the First Plan period, the deposits of scheduled banks increased by Rs. 129 crores, *i.e.* by an annual average of 3 per cent. and during the subsequent five years, corres, ponding roughly to the Second Plan period, by Rs. 602 crores *i.e.* by an annual average of 12 percent. In this decade, deposits increased by 86 per cent. This large increase of deposits was due

to the increasing money incomes of several sections of the people resulting from increasing the note circulation for financing the Plans, combined with the spread of banking habit among them and the establishment of more branches of banks. An indication of the spread of banking habit was provided by the increase in the percentage of deposits of banks to currency in circulation from 72 in 1950 to 86 in 1960.

The structure of deposits changed significantly during the decade. Demand deposits declined from 57 to 36 per cent. of the entire deposits and time deposits increased from 27 to 47 per cent., the savings deposits remaining at about 16 per cent., although their amount was nearly doubled. The number of new deposit accounts increased by 25 lakhs or by about 75 per cent., indicating the spread of the banking habit. The saving deposit, time deposit and demand deposit accounts increased by 16, 6.5 and 2.5 lakhs respectively.

An analysis of the ownership of the deposits showed that personal deposits increased by Rs. 380 crores or 94 per cent. and that business deposits increased by Rs. 168 crores or 54 per cent. The percentage of business deposits to total deposits declined from 37 to 30, that of personal deposits remained almost unchanged at 48 and that of Government and quasi Government deposits increased from 7.6 to 10.7.

Allthough the banking system in India passed through numerous vicissitudes and was subjected to severe strain, during and after the War, its current trends are quite encouraging and the credit structure in the country is sound. The Reserve Bank has been carrying only systematic periodical inspection of all banking companies, one after another and this has helped to strengthen, all round, the traditions of careful and prudent management, which have already been established by many banks. In this connection, it may be noted that the Indian Scheduled banks established the Indian Banks Association in 1946 to protect and promote the rights and interests of Indian banks and to promote in India sound banking principles, practices and conventions, and that the working funds of its members now form 95 per cent. of the total working funds of all the Indian Scheduled banks, except the State Bank of India.

The work of consolidating the progress made by Indian banking during the War was completed by 1957 and since

then banks are making further progress which has become quicker since 1961. Practically all the cities and bigger and medium-sized towns have now adequate banking facilities and the Reserve Bank will not permit the establishment of more banking offices in them for some time. Most of the smaller towns and the rural areas generally lack banking facilities, but Indian banks are now venturing into these areas.

The recommendations of the Committee appointed by the Government of India in 1949 to make suggestions for the extention of banking facilities to rural-areas (Rural Banking Enquiry Committee) and of the Committee on ' Finance for the Private Sector ' appointed by the Reserve Bank of India in 1953 (Shroff Committee) will be considered in Chapters VII and X.

As the Imperial Bank of India could not carry out fully the recommendations of the Rural Banking Enquiry Committee, the Government of India and the Indian Parliament, on the recommendation of the Committee of Direction, All-India Rural Credit Survey, converted it into the State Bank of India on 1st July 1955. A full account of this Bank is given in Chapter X.

The Committee of Direction also recommended the amalgamation of a number of State-associated banks with the State Bank of India. Accordingly, the State Bank of India (Subsidiary Banks) Act was passed in 1959 and State Banks of Hyderabad, Mysore, Bikaner, Indore, Travancore, Saurashtra, Patiala and Jaipur have been made the Subsidiary Banks of the State Bank of India. They function separately, but their policies are directed by the State Bank of India. The Finance Minister has given the assurance on behalf of the Government of India that the Government does not contemplate nationalization of banks. But the ruling political party has accepted the goal of a socialistic pattern of society for India and the Government of India may think of nationalization of banks after some time. Indian joint-stock banks may be able to prevent this development by becoming more liberal in their outlook and policy and playing their proper part in the execution of the Third Five Year Plan and the subsequent Plans of the country, by making finance available to a larger extent to the commerce, industry and agriculture of the country, and by making their services more varied and more efficient, thereby making the Government and the

	Scheduled Banks											
	Banks each with total deposits of Rs. 100 crores and above		Banks each with total deposits between Rs. 25—100 crores		Banks each with total deposits between Rs. 5—25 crores		Banks each with total deposits of less than Rs. 5 crores		Non-Scheduled Banks		All Banks	
	1960	1961	1960	1961	1960	1961	1960	1961	1960	1961	1960	1961
1. Reserves to paid up capital* ..	122	132	105	94	82	87	65	89	55	61	94	101
2. Demand Deposits to total deposits ..	40	43	41	37	40	34	31	32	27	26	40	40
3. Time Deposits to total deposits ..	60	57	59	63	60	66	69	68	73	74	60	60
4. Total paid up capital and reserves to total deposits* ..	3	3	4	4	7	6	10	10	16	17	4	4
5. Cash in hand and balances with Reserve Bank to total deposits ..	9	8	9	8	9	9	12	12	8	9	9	8
6. Balances with the Agent of the Reserve Bank and with other banks to total deposits ..	1	1	1	1	2	3	5	4	7	7	1	1
7. Investments in Government securities to total deposits ..	40	33	26	28	37	33	26	29	26	26	35	31
8. Total investments to total deposits ..	43	36	30	34	42	39	30	34	35	34	38	36
9. Advances to total deposits ..	55	68	70	71	67	69	80	89	63	64	63	69
10. Borrowings from banks to total deposits ..	3	2	7	4	8	6	7	15	2	3	5	4

*In calculating the percentages, paid up capital of banks incorporated outside India has been excluded but their reserves have been included.

public feel that it is no longer necessary to think of nationalizing them. Progressive Indian bankers now feel that too much stress on traditional and rigid practices is out of date and that blind imitation of the policies which may be proper for a highly industrialised, developed and wealthy country like Great Britian is out of place and unwholesome for an underdeveloped country like India. They feel that banking in India must adopt more positive, helpful and flexible policies to help the country's urgently needed economic growth, without thinking always of immediate profit. Sir B. Rama Rau, the Governor of the Reserve Bank of India, at the time of inaugurating the State Bank of India mentioned that India required, in addition to sound banking, wise banking. He defined sound banking as protecting and promoting the interests of the depositors, the shareholders and the institutions generally by making caution, efficiency and integrity the basis of banking practices. Wise banking according to him consisted of the operation of the banking system in a spirit of service in the wider economic interest of the country as a whole, without neglecting the interests of the individual banking institutions. As most of the Indian scheduled banks combine sound banking with wise banking, their prospects appear to be bright.

The principal percentages of banking companies at the end of 1960 and 1961 are given in the table on p. 45.

CHAPTER II

RURAL FINANCE : MONEY-LENDERS AND INDIGENOUS BANKERS

1. *Rural Indebtedness.*—Rural finance is one of the most important economic problems of India, on account of the appalling proverty and the extremely low standard of living of the rural population. According to the Central Banking Committee, the average annual income of an agriculturist in British India was then about Rs. 42 or a little over £3.[1] The same

1 See Report, p. 39.

authority, on the basis of the figures supplied by the Provincial Banking Committees, estimated the total rural indebtedness in India to be about Rs. 900 crores.[1] It appreciably increased afterwards and was believed to exceed Rs. 1,200 crores in 1940 for British India alone.[2] A large part of this chronic debt has been inherited by the present generation from past generations. Social tradition and the custom of each succeeding generation, acknowledging and trying to pay the debts of its forefathers, have been exalted into a legal maxim, *viz.* 'the pious obligation' to pay ancestral debts enforceable in courts of law. Even when no assets have passed and debts are not legally inherited, they are regarded by sons or heirs as debts of honour by the force of tradition. Moreover, there is a general consensus of opinion that this volume of rural indebtedness has been increasing for a century.

The causes of this indebtedness are complex. The more important are the loss of economic equilibrium in the country caused by the decay or destruction of many cottage industries and the scarcity of large-scale industries, a more rapid increase of the population dependent on agriculture than of the area available for cultivation, the increase of uneconomic holdings owing to their sub-division and fragmentation, low expenditure on agriculture, out-of-date methods of production and consequent low production from land per head of population and per acre, the dependence of agriculture on the vagaries of the monsoon, and famines, the burden of land revenue, inefficient marketing of produce, the existence of social habits harmful to progress, the extravagance of the cultivators owing to the lack of business sense resulting from illiteracy, increase in their borrowing capacity owing to the application of Western ideas of property rights to their holdings, and last but not least the defective organization of rural credit with its excessive rates of interest and certain objectionable practices. These pages are concerned with the last cause only, but it should be borne in mind that no organization of rural credit, however excellent, will prove satisfactory unless simultaneous efforts are made to deal with the other causes of rural poverty and indebtedness and to

1 See Report, p. 35.

2 P. J. Thomas, *The Problem of Rural Indebtedness*, p. 19.

make agriculture a paying industry. "The supply of cheap credit is only of advantage to the agriculturist if production is, or can be made, profitable and has indebtedness decreased."[1] Economic progress and the development of banking being inter-dependent, the latter cannot advance in a community steeped in poverty, ignorance and helplessness.

The evils of this indebtedness are the transfer of land from agriculturists to non-agricultural money-lenders, increase of landless labourers, loss of agricultural efficiency, loss caused by the compulsory sale of the harvest to the creditor at a low price as soon as it is gathered, and lack of distinction between loans required for short and long periods. Owing to this lack of distinction, even when a large loan is obtained for capital improvements or for the repaymnt of old debts, a short period is fixed for its repayment, so that the borrower has to use the bulk of his income for this purpose, has not enough left even for his subsistence, and is, therefore, compelled to spend less on his production from land and to allow the production to fall off.

Rural indebtedness presents two separate problems. The first is to devise measures for liquidating the standing indebtedness, a large part of which has been inherited. This problem will be examined in the next chapter. The other is to devise remedies for arresting the future growth of unproductive debt. This will be considered now so far as the organization of a satisfactory system of rural credit is concerned.

7. *Special Characteristics of Rural Finance.*—First of all it is necessary to emphasise that there are certain fundamental differences between agricultural and industrial finance. These give rise to special problems of rural finance that need special treatment and are more difficult to tackle than those of industrial finance.

(1) While other industries have shown a marked tendency towards increasing concentration and scale of production, agriculture has continued to be small-scale, scattered, isolated, individualistic, and relatively unorganized. Moreover, the agriculturists' operations are more complex, longer in their cycle, and subject to special risks from climate and disease, and

1 Foreign Experts' Report attached to Central Committee Report, p. 689.

their capital is sunk in forms of wealth, which only an expert can value, and which cannot readily be accepted as security for loans. Consequently, whereas industrialists obtain their capital by issuing shares and debentures, farmers have to depend largely on their own resources.

(2) It is very difficult to establish a connection between agriculture and the money market, between farmers desiring credit and savers needing investment, through the usual link, *viz.* the commercial banks, because the security that the farmers can offer is not acceptable to the banks. Land, which is the principal security that the former can offer for long-term credit, is regarded as unsuitable by the latter, as it cannot be sold readily, as its price is subject to special influences and can be determined only by special experts, as there may be difficulties in connection with the title to it, and as the right of transferring it may be subject to customary or legal restrictions. Even the more liquid and more readily saleable assets of the farmers, such as crops or live stock, are regarded as unsuitable security by the commercial banks owing to the risk of flood, failure of rains, epidemics among live stock, etc. Moreover, loans to farmers are regarded as frozen credits by these banks, because the repayment of the loans has often to be postponed and spread in small amounts over a number of years owing to unfavourable seasons or a normally small repaying capacity of the borrowers. The banks cannot afford to lock up their funds in this way, because they are obtained in the shape of short-term deposits or call money. This ordinary credit machinery, therefore, which serves the purposes of trade and industries, is not directly available to agriculture.

(3) These difficulties of rural finance are enhanced in India by the illiteracy, poverty, heavy indebtedness, helplessness and uneconomic holdings of the Indian farmers. The need of devising measures to overcome these difficulties is urgent and great, and the nation and the State must interest themselves in the matter, because agriculture is not merely an industry or business, but also a public service rendered by the farmers in national interests for the care and use of land which is the basis of national life. If this is true of Western countries how much more so of India![1]

1 *Cf.* Central Committee Report, pp. 45-8, and Foreign Experts' Report, pp. 689-90.

3. *Credit needs of agriculturists.*—The first step in the consideration of the proper organization of rural credit is to understand the normal credit needs of agriculturists. These may be divided into short-term, intermediate and long-term. Short-term credit is needed for the purchase of manure and seeds, expenses of transplantation, weeding, hoeing, reaping and threshing, the payment of land revenue or rent, and the maintenance of the farmers, their families and their cattle. For this purpose loans should be available to the farmers at short notice, in moderate but adequate amounts spread over nine months or so, and repayable only after the harvest is sold, and the rate of interest should be reasonable. Intermediate credit is needed for the purchase of cattle and agricultural implements and for carrying out improvements in the ordinary course of agriculture, such as levelling, deep ploughing, irrigation, clearance, drainage, and fencing. For this purpose loans should be available to the farmers in adequate amounts for a period of from one to three years at a reasonable rate of interest.

Long-term credit is needed for obtaining fixed capital, invested permanently or for long periods in the purchase of land and costly equipment, the consolidation and improvement of holdings, and the repayment of prior debt. For this purpose the loans should be obtainable in amounts sufficient to enable the farmers to conduct their business effectively, and their repayment should be spread, according to the capacity of the borrowers as determined by their margin of profit from their holdings, over such a period as would not starve the borrowers with regard to their current financial needs, or compel them to borrow elsewhere, or to sell their holdings. Moreover, the farmers need credit, short-term, intermediate, or long-term, for marketing their produce and for rural industries. The Central Committee has mentioned Rs. 300 to 400 crores as a lower limit of the farmers' needs for short-term and intermediate credit in the whole of British India, and has expressed the opinion that there is an almost unlimited scope for the grant of long-term loans.

X The agencies that exist at present for supplying rural credit are money-lenders, professional and non-professional indigenous bankers, co-operative societies and banks, loan offices in Bengal, Nidhis and Chit Funds in Madras, commercial banks including the State Bank and the exchange banks, the Reserve Bank

and Government. We shall now consider their present services, and the improvements that are needed in them.

4. *Operations of money-lenders.*—Both money-lenders and indigenous bankers lend money. But the first difference between them is that while the latter receive deposits, or deal in hundies, or both, which are essentially banking functions, the former do not usually do so. Some money-lenders may now and then use funds temporarily deposited with them for safe custody by their clients, but this business is too uncertain and too small to justify their claim to the title of bankers. Secondly, while the indigenous bankers finance trade and industry rather than consumption, the money-lenders, especially urban ones, finance consumption more than trade. Thirdly, the former are more careful than the latter regarding the objects for which loans are required. Finally, the former's clients repay more punctually than those of the latter and, therefore, the former usually charge lower rates of interest on the whole.[1] It should be borne in mind, however, that the dividing line between money-lenders and bankers is rather thin in many cases.

The indigenous bankers and money-lenders lack a comprehensive organization, as their development has varied in different parts of India according to local needs, habits, customs, and traditions. But, broadly speaking, the money-lenders, usually known as *sowcar*, *bania*, *mahajan*, may be classified into professional money-lenders, either rural or urban, including itinerant money-lenders, and non-professional money-enders such as land-owners, agriculturists, merchants, traders, pleaders, pensioners, jobbers and sardars of labourers, priests and widows, who pursue other activities but lend out their surplus funds.

The professional money-lenders in the villages usually give small loans on a mere entry in their account books, or no entry at all and a verbal promise occasionally backed by an oath, and without a documnet or even a witness, but receive promissory notes when the loans are large, or when old loans are renewed. They usually give loans for current agricultural requirements on personal security on the understanding that the harvest is to be sold to or through them, or on the mortgage of crops. But when the loans are large or given for a long period, security in the shape of mortgages of land, houses, or ornaments, has

1 *Cf.*. The Punjamb Comittee Report, p. 130.

to be supplied to them. Unless they have cultivation of their own, they do not usually accept usufructuary mortgages. They often obtain conditional sale deeds on the understanding that the land would be re-transferred on the repayment of the debt. They make no enquiries regarding the objects for which loans are demanded, and the manner in which they would be utilized. The loans are given in cash as well as in kind. Interest is added to the principal at short intervals, so that this form of compound interest rapidly increases the principal to a large amount. The money-lenders in addition conduct agriculture, trade, and retail shops.[1]

The relations between them and their borrowers are not so friendly nowadays as they were formerly, owing to the loss of interdependence caused by the disintegration of the village community and the legal protection given to the borrowers. The latter often endeavour to take undue advantage of the protection for evading repayment, and the money-lenders resort to several objectionable practices, mentioned below, in order to protect themselves against the risk of losses, so that the attempts at evasion ultimately harm the interests of the debtors themselves. The operations of the urban money-lenders are similar, but on a large scale, and they also advance money on hundis.

Itinerant money-lenders, such as Pathans and Kabulis in most parts of the country, Rohillas in the Madhya Pradesh, Qistwalas and Tharakkars in Uttar Pradesh, and Gossains and Nagas in Bihar and Orissa, supply credit to poor labourers, factory workers, menials, peons and low-paid clerks who cannot obtain credit elsewhere. The sums advanced are usually small and are given for short periods. Formerly their methods were very informal, and bonds or written acknowledgements were seldom taken from the borrowers. But nowadays they usually obtained promissory notes or signatures, or thumb impressions in their khata books from borrowers as acknowledgement of debts. These men as well as other petty money-lenders give loans to borrowers, receiving weekly or monthly wages, also under the instalment or kist system by which a loan of Rs. 8 is repaid in nine weeks by an instalment of one rupee every week, or a loan of 4, 10, 16, or 20 rupees is repaid in 6, 12, 20 or 25 months, by an instalment of one rupee

1 *Cf.* Madras Committee Report, p. 220.

per month.[1] In cases of default, they seldom go to the law-courts, but threaten or use force. Actual force is not used often, as the threat of it proves sufficient in a majority of cases to terrorise the ignorant borrowers, who dare not complain to the police, and who allow themselves to be victimised. The borrowers are also kept in perpetual dread of being victimised. Most of these money-lenders also sell goods, mainly cloth, on credit at a price which covers a usurious rate of interest.

The non-professional landlord or agriculturist money-lenders are often more greedy and exacting than their professional brethren. They lend seed on the security of future crops, or money on that of land, and eagerly wait for the chance of seizing both. Holding a stronger position in the villages than the professional money-lenders they secure the payment of a larger proportion of their claims. The landlord money-lenders especially are the most dangerous, as they get a double hold over their tenant-borrowers, who have to pay both rent and interest, are apt to fall into arrears of one of the two, and are liable to have their crops seized and to be ejected from the land. In other respects their operations and methods are similar to those of the professional money-lenders. Merchant or trader money-lenders give advances to cultivators on condition that the latter's crops are sold to, or through, them. Owners of cotton gins lend money to cultivators on the condition that they sell their cotton crop to them, or get it ginned in their ginneries. Such money-lenders are less exacting in their terms, as the sale of the crops to or through them gives them substantial profits.[2] Other non-professional money-lenders such as lawyers, pensioners, and widows give loans only to acquaintances on the security of land or ornaments.

Loans are obtained from money-lenders for all sorts of purposes. Agriculturists borrow for the expenses of cultivation and the household, or for the payment of rent or land revenue; landlords borrow to pay land revenue or purchase land; tradesmen borrow for the purposes of their business; artisans borrow to purchase raw materials; professional men and empolyees in receipt of fixed salaries borrow for the expenses of medical treatment, or the education of their children; and all classes of people borrow for social ceremonies such as births, marriages and funerals, for payment of earlier debts, and for litigation.

1 See U.P. Committee Report, p. 278.
2 *Cf.* Bombay Committee Report, p. 215.

These money-lenders are generally reasonable as regards the periods for which the loans are given. The short-term loans have to be repaid as soon as the crops are sold, but if the crops fail completely or partially, they are quite willing to extend the period of the loans or to obtain new agreements for larger sums. They do not rush to court to realise the principal as long as the interest is paid, and prefer to give the borrowers every chance to repay the principal. Many of them do not even press for the payment of the principal before the expiry of the period of limitation, unless the security is found to be inadequate. But they insist on the punctual payment of the interest, because it is their chief source of income. Intermediate loans are given for three years or less, and long-term loans for longer periods. Itinerant money-lenders give loans for short periods only, but they do not compel repayment as long as they regard the loans to be safe.

5. *Objectionable practices of money-lenders.*—Many money-lenders, however, resort to various objectionable practices in the course of their operations, such as demanding advance interest, demanding presents for opening business, obtaining thumb impressions of the debtors on blank paper with the object of entering any arbitrary figure later, if the debtors do not pay interest regularly, entering in bonds amounts much larger than those actually lent, manipulating the accounts, taking conditional sale deeds as insurance against the possibility of the evasion of payments by the debtors, exacting free service from the debtors who are thus virtually reduced to the position of serfs, dishonesty in the grant and collection of loans in kind or cattle, and in the grant of loans in instalments. If the money-lenders have any assistant, called *munims*, these have to be paid commissions to obtain loans especially if the security offered by the borrowers is not quite satisfactory. Some money-lenders make the borrowers sign promissory notes by which they undertake to repay the loans in any of the several districts mentioned in them, and if they default, the money-lenders sue them and obtain uncontested decrees in distant places, and then execute them at the places where the borrowers live.

It may, however, be mentioned that most of these practices are not confined to India, and that they prevail in all those countries in which money-lenders thrive. Moreover, money-lenders in India do realise that their prosperity depends upon

that of their clients, and that it is not to their advantage to see them ruined, and on many occasions they do show leniency. Opinion with regard to them is divided. Some condemn them altogether as unscrupulous usurers, land-grabbers and fomentors of factions and law-suits; others commend them as the friends of the peasants, the traditional guardians of their property and ever present helpers in times of need. The truth lies between these extremes.

6. *Interest charged by money-lenders.*—The reports of the Provincial Banking Committees show[1] that in most provinces the rates of interest charged by the money-lenders vary between 12 and 37½ per cent. according to the security and the amounts of the loans and the total amount of funds available in the neighbourhood. Loans secured by ornaments, land, or other property carry the lowest rate of interest. Among the States, the rates are the lowest in the Punjab. The rates charged by the urban money-lenders are generally lower than those of the rural money-lenders, while among the latter the rates charged by the professional and non-professional money-lenders tend to be the same in the same area. Loans given without security carry much higher rates, with a maximum of 300 per cent. The Pathan, Kabuli and Rohilla money-lenders charge from 75 to 360 per cent. as they run a great risk of losing their money. These high rates of interest are due to the operation of the following factors:

(1) In many parts of the country the money-lenders hold a semi-monopolistic position as they are the only credit agency availble to the rural population. Even if other agencies exist, they are not available to all sections of the rural population, and cannot meet adequately the needs even of those sections which they do finance. Many do not like to join a co-operative society owing to the fear of publicity and unlimited liability.

(2) Many villages have no financing agencies, even money-lenders. The needy villagers have, therefore, to go to the nearest village that has a money-lender who, not being personally acquainted with the borrowers, has to charge them a higher rate to cover the risk.[2]

(3) Relatively to the demand, the money-lenders' supply of capital is very inadequate. They have to depend largely upon their own resources. The rural money-lenders rarely

1 See Bombay, Bengal, Madras, Punjab and U.P. Committees Reports, pp. 210-11, 196, 221-7, 31 and 280 respectively.

2 See Bengal Committee Report, p. 199.

obtain deposits from the public, and most of the urban money-lenders do so to a small extent only. The rural money-lenders may borrow from the urban ones, and the latter from the indigenous bankers, but such borrowings are seldom large. Both have generally no connection with the money market. The shortage of their capital is being enhanced by the fact that, owing to the lack of a rational system distinguishing the short-term and intermediate credit needs properly from the long-term needs of the borrowers, their capital is getting frozen year by year.

(4) Owing to ignorance and conservatism, borrowers are unable to examine the feasibility of obtaining loans at lower rates from other, especially urban, centres. For the same reason, there is no public opinion to condemn the high rates.

(5) The expenses of the money-lenders in connection with giving small loans to a large number of borrowers, managing them, and obtaining repayment of them, are much heavier than similar expenses of joint-stock banks.

(6) The security offered by the borrowers is often inadequate. For long-term credit the only security to offer is land. For short-term and intermediate credit the main security is ornaments. But the value of ornaments in mosts cases is small, and in addition womenfolk do not like to part with them, as they are bound up with certain social and religious uses. The other assets are usually of small value. Industrial labourers, landless agricultural labourers, and cultivators who are already indebted have practically no security to offer. Consequently, the money-lenders have to shoulder far heavier risks than other credit institutions in connection with their respective financial operations, and have to charge higher rates by way of insurance against the greater risks. This is brought out in the reports of some of the Provincial Banking Committees which show that the actual gain of the money-lenders has been much smaller than the rates of interest agreed upon originally.

(7) *Laws for checking usury.*—To check usury on the part of the money-lenders, the Usurious Loans Act was passed in 1918. It empowers the courts of law to re-open and examine all loan transactions if they are of opinion that the stipulated interest is exorbitant, or that the transactions are subtantially unfair to the borrowers. Before 1918 the courts had to allow interest at the stipulated rates. The investigations of the Provincial Banking Committees show that the Agricultural

Commission's opinion that the Act has been little utilized so far is not correct, but that certain defects in the Act need removal. There is a general consensus of opinion, however, that the Act, if utilized more freely and fully, is capable of mitigating considerably the evils of usury that prevail in India. Further, the rule of Damduppat in the Hindu Law of Contract, by which interest in excess of the principal cannot be recovered at any one time,has been enforced by the courts in some parts of the Bombay Presidency, in Calcutta, and in Berar. The Bengal Committee recommended legislation on this principle for the whole country,but the Central Committee did not regard the proposal to be practicable.

The Punjab Regultion of Accounts Act, passed in 1930, compels all those who give loans at interest, excluding loans to merchants and manufacturers, to maintain a separate account for each debtor in the prescribed way, showing the date and the amount of the principal of the loan, the rate of interest, and the amount and date of every payment received by the creditor in respect of the loan, and to furnish him half-yearly a statement of account showing the amount of the loan outstanding and all transactions relating to it. Interest must be shown separately from the principal, and if there is no agreement, no portion of the former can be included in the latter. In any proceedings regarding a loan, the courts are authorized to disallow the whole or a part of the accrued interest, if the account has not been regularly maintained by the creditor, or if he has not supplied its half-yearly statement to the debtor. The Central Banking Committee recommended to the Governments of other provinces the passage of similar legislation, and suggested that it should also compel the creditors to give receipts for all repayments made by the debtors, and to keep their counterfoils with themselves.

In most of the provinces laws have been passed on the basis of this recommendation. They compel all money-lenders to maintain proper registers of all their transactions, to maintain the account of each debtor separately, to enter therein all the loans advanced to him, to show the principal and interest separately and to issue receipts for repayments made by him. Some of the Acts (the Punjab, U.P., C.P. and Bombay Acts), compel the money-lenders to furnish a periodical statement of accounts to each debtor, while others (Bengal, Madras and Assam Acts) provide for it on the requisition of the debtor and

on payment of a small fee. Some of the Acts (the U.P., Bihar, Bombay, Bengal and Assam) provide that a copy of the loan document containing the date and principal of the loan, the rate of interest and any other terms agreed between the money-lender and a debtor must be supplied by the former to the latter. Further, the Acts lay down that copies of entries in the account books of the money-lenders, certified in the prescribed manner, shall be admissible in evidence, but that failure on the part of a debtor to protest against a statement of account forwarded to him shall not by itself be regarded as an admission of the correctness of the account. The Acts have provided penalties for failure to carry out the above provision. If accounts are not maintained in the prescribed form, the whole or a portion of the interest found due as well as costs may be disallowed by the court. If a creditor fails to give a debtor a receipt for any payment received, the Bengal and Madras Acts have provided that the creditor shall not be entitled to any interest for the period of default, and the U.P. Act has provided that the court may award the debtor compensation up to double the amount of the payment made by him. The U.P. Act has also provided that any creditor entering in his books of accounts a sum larger than that actually lent shall be punished with a fine. The Bihar and Orissa Acts provide a penalty of imprisonment up to one year, or a fine up to Rs. 500, or both, for not maintaining the prescribed account and for not complying with the other provissons of the Acts.

Furthermore, these Acts provide that courts should reopen the accounts either when the interest is excessive or the transaction unfair. But as the courts are unwilling to exercise their discretion in deciding what an excessive rate is, the Acts have laid down that rates above the rates of simple interest given below should be regarded as excessive.

	Secured loans	Unsecured loans		Secured loans	Unsecured loans
Madras ...	9	15	Bihar ...	9	12
Punjab ...	12	18	Orissa ...	9	12
Central Provinces ...	12	18	Bombay ...	9	12
United Provinces ...	12	24	Bengal ...	9	15
			Assam ...	9½	12½

A court, however, is not prevented from regarding rates below the ones given above as excessive. The Bengal and C.P. Acts

also provide that no court shall decree on account of arrears of interest a sum greater than the principal of a loan. The Bihar Act lays down that arrears of interest in respect of loans granted by a court shall not exceed, when added to interest already paid, the amount of the original principal. The Orissa Act provides that so much of the interest as is in excess of the loan shall be appropriated towards the satisfaction of the loan. Under the U.P. Act, when the total amount of accrued interest on a loan, whether paid or outstanding, equals the principal of the loan, the creditor can realise interest only at the rate at which the Provincial Government borrows, in the case of secured loans, and at two per cent. higher in the case of unsecured loans. The Act further provides that excess interest over this rate shall be credited towards the principal. Finally, some of the Acts (the Punjab, Bengal, Bombay, Bihar and Orissa Acts) have made a provision for debtors to pay in court what is due to a money-lender, if the latter refuses to accept payment before the due date on account of the debtors being credit-worthy, and interest ceases to run from the date of the payment.

Reports received from different States show that some of the above provisions, especially those regarding the maintenance and submission of accounts, are being evaded by unscrupulous lenders in the case of needy borrowers. In other cases, the Acts have restricted the credit available to the agriculturists from the money-lenders. The gain to them, however, is that they are learning to live within their means, and to join co-operative credit societies if they have to borrow. Moreover, honest money-lenders have nothing to fear from these Acts, which are meant to deal with the objectionable practices and dishonest money-lenders.

8. *Decline of money-lenders.*—The business of money-lenders has declined in recent years, insolvencies among them have increased, and more than one Provincial Banking Committee has mentioned this fact. The following are the causes of this decline:

(1) The money-lenders have to fight against great difficulties in securing the repayment of their loans. Court proceedings for the recovery of debt are very expensive, and there is much delay in obtaining decrees of the courts as well as in executing them.

(2) Some Acts passed for protecting the borrowers, such as the Land Alienation Acts, the Usurious Loans Act and the Civil

Procedure Code, etc. have increased the difficulties of the money-lenders. There are several cases of persons borrowing money from them with no intention of repaying it, and taking the protection of the Insolvency Act.[1]

(3) The growth of co-operative societies has curtailed their activities.

(4) The general economic depression has produced the same result.

(5) Some money-lenders are tempted by the counter-attraction of trade to leave their villages and to seek their fortunes as traders in the smaller towns.

(6) The relations between them and the borrowers are becoming strained on account of the growth of other credit agencies, the legal protection to the borrowers mentioned above, the decay of the village community with its solidarity of village life, the recent nationalist movement that has made the mass conscious of their rights, their suspicions against the whole money-lending class on account of the objectionable practices of some of its members, and the economic depression which has increased the burden of debts and reduced the debtors' capacity to repay them. This estrangement is seen from the recent increase in crimes against the life and property of the money-lenders. It threatens the basis of India's rural economy, of which the money-lenders have been an indispensable feature. While the borrowers are showing an increasing desire to loosen the grip of the money-lenders, the latter are trying to tighten it by abandoning some of their old informal methods, and adopting new informalities, such as insistence on promissory notes from the borrowers in place of verbal promises, and by insisting on the repayment of loans in cash in place of repayment in kind. These efforts, however, have not arrested their decline.

This decline is regrettable because the money-lenders are still an indispensable part of the country's rural economy. They are accessible at all times of the day and even at night. Their methods of business are simple and elastic. They maintain a close personal touch with the borrowers, and often have hereditary connections with their families. They do not keep their borrowers waiting for their loans until the time for utilizing them profitably has passed. They do not conduct embarras-

1 See Jain, *The Monetary Problems of India*, p. 65.

sing enquiries into the financial condition of the borrowers' They do not press for the repayment of loans at due date if they know that such repayment is inconvenient. Their local knowledge and experience and presence on the spot make it possible for them to lend to persons having no definite assets, and yet to protect themselves from losses.[1] Such an important section of rural society must not be allowed to disappear. It should be reformed and strengthened.

9. *The question of licensing money-lenders and suggestions for reforming them.*—The Bengal and Central Provinces Banking Committees recommended that legislation should be passed compelling all money-lenders to obtain licences from Government and making the practice of money-lending without a licence a punishable offence, on the grounds that without a licencing system the objectionable practices of unscrupulous money-lenders could not be eliminated for the benefit of the masses, and that such compulsory licensing or registration had worked well in the cases of the legal and medical professions.

The Madras, Bihar and Orissa, Burma, and Central Areas Committees and Mr. Subedar, however, recommended only voluntary registration of money-lenders on the grounds that (1) most of them would strongly object to any restrictions on their operations; (2) owing to their strong position, the restrictions would either be evaded or, if effective, would worsen the position of the illiterate borrowers who were dependent upon them and could not afford to lose their goodwill; and (3) it would be difficult to provide for the compulsory licensing of the non-professional money-lenders.

The terms suggested for the licence were that (1) the rate of interest charged by the licensees must be within a certain maximum; (2) they must keep their accounts in a prescribed form and must allow them to be examined periodically by Government auditors; (3) they must keep a separate account for each individual borrower, and supply a copy of it to him periodically; (4) they must give receipts to all borrowers for repayments and keep the counterfoils with themselves; and (5) if they charged compound interest, the period of rests must not be less than a year.

In return for these restrictions the licensed money-lenders should be given certain privileges, such as the recovery of loans

1 See Bombay and U.P. Committees Reports, pp. 208 and 47.

given by them against agricultural hundis or warehouse receipts by the procedure that was applied to the recovery of public demands, advances of money to them from banks on the security of their agricultural paper, the same remittance facilities to them as those given by the Imperial Bank to other banks and by post offices to co-operative societies, and the facility to them of opening current accounts with post offices withdrawable by cheques. The Bombay, Punjab and Assam Committees and Central Committee were not in favour of a licensing system either compulsory or voluntary, for the money-lenders on the following grounds.

The proposal to establish a system of licensing money-lenders had been made for two purposes: to lower the high rates of interest charged by them, and to check the objectionable practices of some of them. The first object could be secured only by the progress of mass education, the development of habits of thrift and saving among the masses, and the promotion of co-operative and joint-stock banks. This would take time, and in the meanwhile all that was practicable was (1) to make a fuller use of the Usurious Loans Act; (2) to take steps to reduce the hardships experienced by honest money-lenders in recovering their dues, so as to reduce their expenses and to enable them to reduce their charges to honest borrowers; (3) to induce money-lenders to join co-operative societies on the condition that they did not lend privately to the members of the societies; (4) to entrust selected money-lenders with the agency functions of joint-stock banks, such as accepting deposits, and making remittances and payments; (5) to transform them into regular branches of the banks as business developed, or to make them partners of the banks if the banks desired to avoid the expenses and heavy liabilities of opening new branches, without losing the advantages of the unlimited liability and local knowledge of the money-lenders; and (6) to make those who were prepared to abandon business other than banking, members of the Reserve Bank.

To secure the second object *viz.*, the elimination of the dishonest practices of some money-lenders, (1) the Usurious Loans Act, which authorized courts to take into account some of them in dealing with cases coming before them, should be utilized more freely and fully; (2) legislation on the lines of the Punjab Regulation of Accounts Act should be passed in

other States as mentioned before; (3) additional legislation should be passed on the lines of the English Money-lenders' Act prohibiting money-lenders from levying any charges for expenses relating to the grant of loans, and from increasing interest on account of a default in repayment, and preventing the enforcement of contracts for the repayment of money lent to them, unless there were notes or memoranda in writing of the contracts made and signed by the borrowers before the money was lent; (4) district authorities should watch the operations of Kabuli or Pathan money-lenders, and should prosecute them if they were found resorting to violence or threats of violence against their borrowers, and Government should deport, under the Foreigners' Act or special legislation, those who were found continuing these practices in spite of prosecutions against them;[1] (5) courts should be empowered to dismiss suits brought before them by money-lenders for the recovery of sums due from borrowers living in distant places; and (6) State Governments should conduct propaganda and education of the masses regarding their rights under these laws and the protection given by the laws against malpractices, and the services of school masters, post masters, pleaders, etc. should be used for this purpose.

Registration and licensing of money-lenders have been so far provided in most of the States by means of legislation. Some Acts make the carrying on of business by an unlicensed money-lender, illegal and punishable by a fine. The other Acts merely disallow suits for recoveries of money by an unlicensed money-lender, so that a money-lender has to obtain a licence before his suit or application can be heard by a court. A licence may be cancelled by the Registrar or relevant court on the grounds that a money-lender is guilty of fraud, or that he has contravened the provisions of the Act, or that he is unfit to carry on the business of money-lending. The Acts prohibit (1) levy of compound interest, (2) charges for expenses on loans not specifically provided in the Acts, (3) false claims under principal, (4) molestation and intimidation of debtors, (5) contracts to make payments outside the State, (6) conversion of arrears of rent into debts due by landlords, and (7) non-compliance with provisions regarding accounts and returns. The enforce-

1 See Bombay Committee Report, p. 218, Central Committee Report, p. 92, and Bihar Committee Report, p. 181.

ment of the registration of a large number of money-lenders and of the prohibition of the above practices is proving difficult in all the States concerned, and cannot be adequate without inspection and supervision of the activities of money-lenders by State Governments.

Replies to the Questionnaire of the Committee of Direction, Rural Credit Survey, confirm the general impression that there is large-scale and country-wide evasion of the restrictions imposed on the money-lender. Borrowings from professional as well as agricultural money-lenders at rates of 50 per cent. and over have been reported from most States. The modes of evasion reported are as numerous as they are ingenious. Only a few need be mentioned by way of illustration : (i) obtaining a pronote for a larger amount of principal than that actually lent ; (ii) interest computed at illegal rate and deducted in advance from the amount lent; (iii) the making of a separate pronote (besides the main one) in the name of a servant or relative of the money-lender to cover the extra interest; (iv) forward purchase, together with false evaluation, of the debtors' produce; (v) conditional sale; (vi) unobjectionable sale deed for purposes of the law, and illegal, if informal, understanding as to the real substance of the contract; and (vii) taking over of debtor's land on usufructuary mortgage on terms which in effect imply the charging of illegal interest or taking on mortgage the milch cattle of the debtor on a similar basis. There is reason to believe that, in addition to all this, much the larger part of money-lending is carried on without licence, even where such licence is obligatory. There is, besides, some evidence of contraction of credit—which to the extent that it may have restricted wasteful forms of expenditure cannot be regarded as an unmixed evil—as also of the increased cost of credit to the agricultural borrower through the money-lender discounting the additional risks involved in his illegal transactions.

10. *Operations of indigenous bankers.*—As a credit agency that has stood the test of political and economic vicissitudes for centuries, indigenous bankers hold a unique position with regard to the magnitude of their operations and their importance to society. While money-lending is carried on by people belonging to all castes, indigenous banking is mostly confined to certain castes, which are known as the banking castes. It is purely a family business, and hereditary in the families belonging to

these castes. The principal caste engaged in banking is the Vaishya, in which the Jains, Marwaris and Chettis must be included. The Vaishyas and Jains are spread all over the country. The Marwaris have their homes in Marwar State in Rajputana and in Central India, but many of them have migrated to Bombay, Calcutta and other trade centres. The operations of the Chettis are mostly in Madras and Burma. The Khatris, who claim to be Kshatriyas, operate in the Punjab. Then there are the Shikarpuri Multanis, who flourish in Sind and Bombay, and the Rehtis or Bohras who work in Gujarat and the north-western part of Uttar Pradesh. The number of Mohammedans operating as money-lenders or indigenous bankers is small, as they are prohibited by their religion from receiving interest. The number of Mohammedan money-lenders, however, is gradually increasing, as they either ignore this religious prohibition, or evade it by taking interest in kind. Two Provincial Committees have mentioned that the Mohammedan attitude towards the taking of interest is changing.[1]

The indigenous bankers, usually known as *kothiwals*, *sarafs*, *shroffs* or *chettis*, may be divided into urban and rural; those whose entire or principal business is banking proper; those whose principal business is trading but who employ their surplus funds in banking; and those who divide their funds and energies more or less equally between banking and trading ; and those whose methods are antiquated, and those who are gradually taking to modern methods.

Some of these bankers have offices and branches in several parts of the country and several trade centres, including Bombay, Calcutta, Madras, Delhi and Rangoon. The branches are managed by their agents, who are known as *munims* or *gumastas*. These are given large powers, and are known for their honesty, industry and efficiency, although they are not highly paid. They submit periodical returns and reports of their work to their head offices, obtain instructions from them, and their books and accounts are carefully audited at intervals by the indigenous bankers themselves.

Although the indigenous bankers act independently of each other, some of them still have a few guilds of ancient origin,

1 See Bengal and Punjab Committees Reports, pp. 195 and 18.

usually known as the *mahajan*, functioning in the north and south of India. Though the bulk of their activities are social and religious, they settle disputes among their members, and function as insolvency courts. In modern times the bankers have established a few associations, such as the Shroffs' Associations in Bombay, Ahmedabad and Calcutta, the Marwari Chamber of Commerce and the Multani and Shikarpuri Bankers' Association in Bombay, the Marwari Association in Rangoon and the Bankers' Association in Delhi. They have proved useful in bringing the bankers together, binding them to each other in their common interests, and settling their daily disputes, which otherwise would have had to be referred to the law courts. Members of one association have dealings with those of another, and joint meetings of the associations are sometimes held to discuss matters of common interest, but there is no organization for the interchange of intelligence concerning the credit position of the constituents and for the enunciation and adoption of uniform policy and methods of work.[1] There is also no co-ordination among the various classes of bankers, although certain sections of them, such as the Marwari and Chettiyar bankers, are united by a strong communal feeling, and are known, for their readiness to help other members of their castes in times of difficulty.

These bankers receive no banking education beyond what they learn in the course of their business and from the previous experience of their firms. Their operations are free from formalities and delays. They are available at all times. Their establishments are small and economical. Their accounts are simple and economical, yet accurate and efficient. No audit is needed, and no balance-sheet is to be prepared. No separate accounts, funds or establishments are kept for banking and trading. Knowing the family history of customers and the details regarding their business and financial position, the bankers know easily to whom to lend, and to what extent. Moreover, after giving loans they can watch the doings of their borrowers much more closely than modern organized banks can do. The rarity of failure on their part to make payments whenever demanded, and their readiness to meet any emergency and to maintain the prestige of their firms under any circumstances show that they keep substantial cash balances. Their

1 *Cf.* Bombay Committee Report, p. 194.

methods of business, unlike those of the ordinary money-lenders, are marked by a high sense of responsibility and probity, and so they are held in esteem and confidence by traders and the public. They regularly supply their clients with copies of their accounts, as the latter are educated men and therefore able to understand the accounts.

These bankers receive deposits from the public either on current account or for fixed terms, and pay interest on them at rates varying between 3 and 9 per cent. according to the seasons, the amount and duration of the deposits, their relations with the depositors, and their own standing. The deposits are accepted under the 'Khatapeta' system. A receipt is given or received only when money is deposited or withdrawn through a bearer. Otherwise, entries in the banker's ledger are regarded sufficient for deposits made, withdrawals effected, and interest received or paid. But while modern banks depend to a large extent upon deposits for their working capital, these bankers do so to a small extent only. Some of them, especially the Multanis and Marwaris, hardly receive deposits from the public, and rely mostly on their own resources and loans from members of their own castes living in Shikarpur and Rajputana respectively. The Multanis also depend substantially upon the financial facilities provided by the State Bank. Moreover, the volume of deposits obtained by the indigenous bankers has been declining in some parts of the country in recent years, owing to the increasing competition of co-operative and joint-stock banks and Government which, by the publicity of their operations and their business-like methods, supply a greater sense of security to the depositors. Withdrawals from the deposits are usually in cash, and not by means of cheques. Some bankers issue cheques and pass-books in the vernaculars, but these cheques are not accepted, as a rule, by the joint-stock banks and the State Bank, and have only a limited local circulation. These bankers also replenish their resources in the busy season by borrowing from one another, or from those merchants who have surplus funds. In the cities they obtain accommodation to some extent from the State Bank and the joint-stock banks on demand promissory notes drawn by two approved bankers, or by discounting hundis endorsed by them.

The indigenous bankers generally find it impracticable to

establish direct relations with agriculturists, and so finance them through local money-lenders and traders. They have stopped giving loans against agricultural land in those provinces in which Land Alienation Acts are in operation.[1] They have kept themselves in close touch with traders and small industrialists, and have enabled the agricultural and industrial products of the country to be brought to the markets. In financing them they do a considerable amount of general banking business, such as buying and selling remittance, discounting hundis, receiving deposits, and giving loans against stock-in-trade.[2] In a few industrial centres some bankers keep a portion of their funds on deposit for fixed terms with textile mills. At the end of the fixed periods, they may renew the deposits at a higher or the same rate of interest, or may withdraw them and keep them with other mills which offer higher rates or provide a better sense of security, or may use them in other and more profitable directions. Beyond this, the bankers do not finance large-scale industries. Even this finance is defective because, although the depositors obtain a good rate of interest, *viz.* 7 or 8 per cent., find their funds fairly safe, and periodically are free to transfer them to better investments, this practice means that the long-term needs of the mills have to be met to some extent by the short-term deposits of the bankers.

One of their usual methods is to lend money on written demand promissory notes. In the case of the larger loans, the notes have to be attested by sureties, otherwise a much higher rate of interest is charged. A second method is to obtain receipts signed by the borrowers acknowledging the loans, and stating the agreed rate of interest, in place of the promissory notes. A third method is to give advances against bonds written out on stamped legal forms, which state all the conditions of the loans in detail, including higher rates of interest if the loans are not repaid on the due dates, and which are duly executed. A fourth method is to make the borrowers put down their signatures in the bankers' books to which stamps have to be affixed, undertaking to repay the loans, but the conditions of the loans and the rates of interest are not stated, and are left to verbal agreement. This method is analogous to the modern system of book credits.

1 See the Punjab Committee Report, p. 125.

2 See Bombay and Bengal Committees Reports, pp. 199 and 187.

A fifth method is to lend on the mortgage of land, houses or other property. This method in used in the case of large loans, and a lower rate of interest is charged. The mortgage deeds have to be registered by the Registrars or Sub-Registrars of the districts in which the properties are located. The mortgages may be either ordinary, in which the possession of the mortgaged properties is retained by the mortgagors, or usufructuary, in which the possession is handed over to the mortgagees who receive the income therefrom as interest. Ordinary mortgages are more common than usufructuary ones. The usufructuary mortgages are either ordinary, in which all the income from the mortgaged properties is enjoyed by the mortgagees, or those known as *Zarpeshg* in which any surplus in the income over the stipulated interest has to be paid to the mortgagors. Usufructuary mortgages may be accompnied by the condition that, if the loans are not repaid by a certain date, the transfer of the properties will become absolute and unredeemable. In the absence of such a condition the borrowers can recover their properties at any time after repaying the loans.

Finally, the indigenous bankers draw and discount hundis, *i.e.* indigenous bills of exchange. They are *darshani* or *muddati*, *i.e.* demand or usance bills, the latter being payable after a certain period mentioned in the hundis and calculated from the dates on which they are drawn. The muddati hundis are usually drawn payable on the 11th, 21st, 31st, 41st and so on, up to the 361st day. No days of grace are allowed if the hundis are of less than 11 days' maturity. For those of 11 to 21 days' use, 3 days of grace are allowed, and for those of longer usance 5 days. The hundis are also *dhanijog* or *sahjog*. In cashing the latter a banker has to make sure that the presenter is the proper person entitled to payment, but he is free from this responsibility in cashing the former. Further, the hundis are *dekhanhar* or *firmanjog*, *i.e.* payable to bearer or order. Finally, the hundis may be purely finance bills, *i.e.* they may be drawn by merchants, who need money, on their agents, firms or others with whom arrangements have been made beforehand, or they may be drawn as a convenient form of remittance of money from one place to another. Or they may be trade bills drawn against produce or goods. But there is nothing in them to show whether they are finance or trade bills. Hundis can be discounted and rediscounted any number of times, and sent

to a number of different places, by means of endorsements on the back before they are cashed on maturity. Every endorser of a hundi is responsible to the holder for its payment. The dishonouring of a hundi is very rare, because it is regarded as equivalent to the bankruptcy of the drawer.[1]

The rate at which the hundis of small traders are discounted by the indigenous bankers is called the bazaar rate. It varies in every locality between 4 and 12 per cent., according to local conditions and the nature of the season. A difference of as much as 3 per cent. may exist between the Bombay and Calcutta bazaar rates at the same time, showing that there is no free flow of capital even among the indigenous money markets of these two Presidency towns. The rates of interest charged by the bankers on secured loans vary between 6 and 18 per cent. according to the nature of the security and the amount and period of the loans, and on unsecured loans they vary between 18 and 37½ per cent. according to the standing of the borrowers. These rates are not subject to seasonal fluctuations, or to serious fluctuations in the cases of individual borrowers.

11. *Decline of indigenous bankers.*— The majority of indigenous bankers combine banking with trade, and their capital engaged in banking cannot be distinguished from that engaged in trade. The principal exceptions to this are the Nattukottai Chettis of Madras and the Multanis of Bombay. The majority of the others trade or speculate in grain, cotton, jute or other agricultural produce, cloth, or precious metals, or act as general merchants, commission agents, brokers, goldsmiths, or jewellers, or are managers or proprietors of sugar, flour, or oil mills, or cotton, jute, silk or glass factories. Moreover, some Provincial Banking Committees have pointed out that their banking business has tended to decline in recent years, and that they are trying to make up for this loss by developing other activities.[2] The following are the reasons for this decline:

(1) While the competition of co-operative and joint-stock banks, including the State Bank, has been increasing, the majority of the bankers still cling to their antiquated methods.

1 For further details regarding the indigenous bankers' methods of business see Jain, *Indigenous Banking in India*, Chaper III, and Bombay, Bengal, Madras and U.P. Committees Reports, pp. 197-8, 188-9, 187-8 and 267-70 respectively.

2 See the Punjab and U.P. Committees Report, pp. 124, 275.

Generally speaking, they find it difficult to compete with the State Bank in remittance, with the co-operative banks in deposits, and with the joint-stock banks in advances, as the State Bank has special facilities for remittance, the co-operative banks, being under the aegis of Government, inspire greater confidence among depositors, and the joint-stock banks have the advantages of large-scale operations and quick business-like despatch.

(2) The heavy stamp duty on hundis has restricted their hundi business.

(3) The legal facilities permitted under the Bankers' Evidence Act are not available to them.

(4) The establishment of branches by exporting firms is depriving them of agency business in the mandis (markets) of the interior.

(5) The expansion of trade in India is increasing their opportunities to engage in it.

(6) They are tempted by the greater facilities for speculation in trade than in banking.

Only a few of them are abandoning their antiquated banking methods, and are taking to modern banking methods, such as issuing pass-books and cheque books, cashing cheques and receiving savings bank deposits. The most notable instance of this development is the Bank of Chettinad Limited in the Madras State, which was formed in 1929 by a number of Nattukottai Chetti bankers and registered under the Indian Companies Act, and which has now about 40 branches in Madras, Burma and Ceylon.

12. *Relations of indigenous bankers with commercial banks.*—Indigenous bankers, whose names are on the approved lists of joint-stock banks and the State Bank, obtain cash credits from them, against demand promissory notes signed by two of the bankers, or by one banker and one merchant, or discount with them hundis drawn by traders and endorsed by the bankers, up to a certain limit assigned by them to each banker according to his financial standing. In the majority of cases, however, the accommodation which the bankers obtain from the banks is neither free nor regular, and is sought by them occasionally and only during the busy season, when their resources fall short of the accommodation demanded by small traders and cannot

be replenished from other bankers. Otherwise, they borrow from each other, as they can usually do so at a lower rate than that charged by the State Bank and the other banks, and without submitting themselves to various inquiries and formalities. Thus, the general impression is that the indigenous bankers do not receive all the support that they should from the State Bank and the joint-stock banks.[1] These banks also refuse to accept cheques drawn on the bankers or crossed in their names. This is due partly to their difficulty of supplying sufficient security, and disinclination to publish a balance-sheet or divulge their accounts, making it difficult for the banks to determine their financial position, and partly to their not being recognized as possessing the status of bankers. At the same time, it is true that the banks occasionally treat applications for credit from indigenous banking firms having an honourable history behind them with too little sympathy, and insist too rigidly on the observaion of mere formalities.

In discounting hundis, the banks prefer trade bills to finance bills because, although the direct security even in the case of trade bills is only personal owing to the absence of documents, such as warehouse receipts, they inspire more confidence, being backed by actual goods. Moreover, the banks do not take the hundis direct from the small traders, as reliance upon the latter's personal security would involve undue risks, and insist upon the endorsement of the indigenous bankers on the hundis that they discount, so as to make this business safe.[2] Such endorsement is necessary before the hundis can be rediscounted by the State Bank, because it is prevented by the Act governing it from discounting a bill unless it is endorsed by two independent persons. The indigenous bankers also obtain remittance facilities from the State Bank on the same terms as the public. They do not get the special terms given by the bank to the joint-stock banks, as they do much less business with it than the joint-stock banks.

It is a grievance of the indigenous bankers that the officers of the State Bank, especially the agents of its mofussil branches, take little interest in the bankers' business and needs and that some branches of the State Bank show a lack of consideration even to old, reliable and substantial firms, and sometimes

1 See Bombay and U.P. Committees Reports, pp. 201 and 274.

2 See Jain, *Indigenous Banking in India*, p. 176.

refuse to rediscount hundis bearing their endorsement. It is a defect of the Indian banking system that the two important credit agencies, whose co-operation would be most advantageous for trade and industry, thus remain aloof. There is no correlation of the operations of the bank and of the bazaar consisting of the indigenous bankers, and so the bazaar hundi rate is often different from the bank's rate for discounting hundis. Further, no connection has yet been established between the Reserve Bank and the indigenous bankers. In the absence of co-operation between the indigenous bankers and the central bank and other banks, the development of an open market for discounts and of a co-ordinated credit policy is impossible.

13. *Defects in the organization of indigenous bankers.*—The present organization of the indigenous bankers thus suffers from the following four principal defects :—

(1) The majority of them are conservative, and jealous of each other, lack adaptability and initiative, and continue antiquated methods of business, often in isolation and secrecy, making impossible the creation of public opinion which alone can enable them to sustain their role. This is due partly to the fact that, being confined to certain families, the class has not been strengthened by the infusion of fresh blood into it, and partly to poor contact with organized banking in the country.

(2) The majority of them have a comparatively small deposit business, or dealing in other people's money, which is a fundamental feature of organized banking. Consequently, the savings of the country, instead of being mobilised, as deposits, and made available for exploiting the resources of the country, have remained inert, and the evils of money-lending have increased.

(3) Hundis play a small part in their finance of trade, the bulk of which is financed with cash.

(4) There is no regular contact between them and joint-stock banking in India, so that two money markets exist side by side with two sets of rates. Moreover, the indigenous bankers conduct their operations as independent units, and the central authority does not yet co-ordinate their activities and secure team work from them.[1] The banking reserves are widely scattered over the country, and are lacking in mobility as, owing

[1] *Cf.* Jain, *Indigenous Banking in India*, p. 186 and the U.P. Committee Report, p. 275.

to the want of effective correlation, it is difficult to move them from the centres where they are redundant to other centres where they happen to be inadequate.

14. *Suggestions for reforming indigenous bankers.*—It is necessary to take steps to remove the above defects in the organization of the indigenous bankers, to link them with the general banking system of the country, to raise their status, to improve their position and banking methods, and to make them useful members of the banking system, for the following three reasons :—

(1) For banking facilities in some of the small towns and all rural areas, agriculturists, traders, merchants and small industrialists are dependent entirely on the indigenous bankers and money-lenders. Even in those towns, which have a bank or a branch of a bank, these bankers supply valuable banking facilities to merchants, traders and small middle class industrialists. It will be a long time before the joint-stock banks, the State Bank and co-operative institutions can supply banking facilities to all parts of the country and replace the indigenous bankers.

(2) The rates of these bankers do not compare unfavourably with those of the banks, but they have fallen on bad times and have begun to decline. Although they urgently require more funds to increase the turnover of their business, so as to counter the effects of the narrowing margins between borrowing and lending rates, they do not get them, partly owing to their own defective organization, and partly owing to conditions that they cannot control.

(3) They have been traditionally dealing in hundis, and their experience and organization regarding them will prove very useful in the development of the bill market that is necessary to make the Indian banking system sound.[1] The fullest use should, therefore, be made of their invaluable knowledge of local conditions, personal contact and relationships extending over several centuries, and banking methods, and by reforming these methods in the light of modern developments, the bankers can be made to play a much more important part in the Indian banking system, to accelerate its progress, and to become a source of great strength and solidarity to it.

The measures of reform, however, must not be compulsory. Compulsion will merely accelerate their transfer from banking

1 *Cf.* Foreign Experts' Report, Central Committee Report, p. 656.

to other business activities. The object must be to extend and modernise their banking activities, and to restore them to the position that they held in the country till the middle of the 19th century. Therefore, (1) as recommended by the Central Banking Committee, those indigenous bankers, who already confine their activities to banking proper, and those who are ready to give up their other business and to restrict themselves to banking, should be eligible to be placed on the approved list of the Reserve Bank, and to obtain re-discount facilities from it in the same way as joint-stock banks. The Reserve Bank must further lay down that they must own a minimum amount of capital. They will also have to keep proper books of accounts, to have them audited annually by auditors recognized by Government, and to allow them to be inspected by the Reserve Bank, whenever it desires to do so.

Although the Reserve Bank of India has been in existence, since 1935, the adoption of the above scheme of bringing indigenous bankers into direct relation with it has been postponed on the ground of practical difficulties as explained later in the chapter on the Reserve Bank.

(2) The Reserve Bank, the State Bank and other banks should use those indigenous bankers, who are members of the Reserve Bank, as agents for the collection of bills and cheques, and the Reserve and State Banks should give them the same remittance facilities that are given to joint-stock banks.[1]

(3) The benefits of the Bankers' Book Evidence Act should be extended to them.

(4) A substantial proportion of the indigenous bankers will not be able to give up their business activities other than banking, and will not, therefore, be able to obtain banking facilities from the Reserve Bank. They will have to continue to depend upon the State Bank and joint-stock banks for these facilities. Some of the Provincial Committees and the Central Committee have, therefore, recommended that these banks should grant such facilities to the bankers more liberally in future, and should especially discount their bills more freely, because the Committees have found that the complaint made on behalf of these bankers, that they do not often get all the banking facilities

1 *Cf.* The statement of the Indian Merchant's Chamber, Bombay, Central Committee Evidence, Vol. II, p. 538.

which they deserve to get according to the security offered by them, has some justification. Further, to bridge the gulf between the bankers and banks, to remove from the minds of the former suspicion of unfair or unsympathetic treatment from the latter, to assure them that their applications for financial assistance would receive due consideration from the latter, and to help the banks to assess the financial position of the bankers, local advisory committees consisting of the leading bankers should be appointed by the boards of directors of the banks at centres where they have branches.

(5) The Central Committee has suggested that the indigenous bankers, who will be placed on the approved list of the Reserve Bank, should be eligible to become full members of the All-India Bankers' Association, when it is established as suggested by the Committee, and that the other bankers should be eligible to become its associate members so as to receive a stimulus for the adoption of modern methods. In addition, local associations of the bankers should be established in different centres for promoting co-operation among the bankers of each centre.

(6) The indigenous bankers should themselves reform their methods so as to make them conform more to those of joint-stock banks in respect of accounts and audit, use of bills and cheques, prompt receipt and payment of money, and conduct of operations strictly according to legal requirements, as this will enable them to occupy the position in the Indian banking system to which they are entitled by their importance.

(7) They and the joint-stock banks should carefully consider the feasibility of becoming partners so as to extend the activities of both and to supply improved and larger banking facilities to the trading community. Those bankers who do not find this suggestion practicable should be entrusted with the agency functions of joint-stock banks.[1] They should also examine the feasibility of amalgamating their business into joint-stock banks. Such banks can prove very useful in developing the banking habit among the people, in mobilising the dormant capital resources of the country and making them available for the economic development of rural areas, in giving accommodation to agriculturists and traders on reasonable terms and in developing the use of bills in place of cash in the finance of agricultural and trade operations.

1 See Bihar Committee Report, pp. 210-11.

(8) The indigenous bankers should consider the practicability of undertaking and developing bill-broking business, and performing the same functions in the Indian money market as those which are performed by the bill-brokers in the London money market.

The reports of the Provincial Committees show that the indigenous bankers in spite of their conservatism are not averse to modifications of their methods and practices if they are convinced that the modifications are practicable and profitable. It is for the banking experts, commercial leaders, and captains of industry of the country to induce them to reorganize themselves and to reform their methods on the lines indicated above.

15. *Finance of marketing of crops.*—We may now turn to the finance of marketing of crops with which money-lenders and indigenous bankers are closely concerned. It is a common practice of the cultivators to obtain advances of money against their growing crops. The money-lenders, who are also traders, do not charge interest if the borrowers undertake to sell their crops to the lenders on a fixed date, at a particular price fixed much below the anticipated market price. But in most cases the advances bear high rates of interest ranging from 12 to 75 per cent. and the borrowers bind themselves to sell the crops to or through the lenders at prices lower by 5 to 25 per cent. than the anticipated market prices. The lower the contract price, the lower is the rate of interest charged. If the contract is to sell the produce at the market price, a high rate is charged.

Secondly, even if the cultivators do not borrow money to raise their crops, owing to their previous indebtedness they are pressed heavily by the money-lenders as soon as they have harvested their crops, and are compelled to sell them immediately, with the result that the prices get depressed by the glut in the market. As regards the crops that are to be exported, there is no remedy for these evils until orderly marketing is organized. But as regards the crops that are produced for home consumption, the evils can be effectively checked by the creation of co-operative sale societies, which will give advances to the cultivators and enable them to wait for the sale of their produce until favourable prices become available, and which will then act as their agents for the sale of their produce at favourable prices.

To proceed to the methods of marketing finance, and the rates charged for providing it. The village money-lenders and traders buy agricultural produce from the cultivators and usually pay cash. They work partly with their own capital, and partly with funds borrowed from town merchants, commission agents, and indigenous bankers at rates varying from 12 to 24 per cent. In some parts of India the commission agents in turn borrow funds from the indigenous bankers at rates varying from 6 to 12 per cent. These high rates compel them to offer low prices to the cultivators. Most of these transactions are not financed by means of hundis, and so they lose the benefit of direct contact with the money market. If the use of hundis is encouraged to finance these transactions, the hundis can be discounted in the money market, and the finance can be secured at much lower rates.

When produce is sent from one substantial middleman to another, it is frequently financed by drawing hundis, darshani or muddati, which are either clean or supported by railway receipts, and which are discounted with the indigenous bankers, or the joint-stock banks, or the State Bank of India. The use of muddati hundis has diminished in recent years. Banks prefer hundis backed by railway receipts, as they reduce the bank's risks, but many of the receipts have to be sent direct to the consignees, who insist upon getting them direct, to maintain their prestige, or to obtain advances against them to pay the hundis, or to save demurrage. The indigenous bankers supply credit to the middlemen also on pronotes or personal security.

In some parts of India, some of the joint-stock banks, and especially the State Bank, advance large sums against the security of produce, which is kept in the godowns of the banks. But in other parts, such advances are smaller owing to the disinclination of merchants to pledge stocks with the banks because of the rigidity of the banks' regulations regarding these advances and the publicity given to these advances. But the Provincial Committees have reported that everywhere the disinclination of merchants and traders to pledge their stocks with the banks is gradually diminishing. For their own benefit, merchants and traders should endeavour to use the goods in their possession as much as possible to get cheaper accommodation from banks. The State Bank and the joint-stock banks should also give advances more freely against agricultural produce kept in their godowns.

Further, to enable merchants and traders to obtain cheaper accommodation by way of advances from banks on the security of produce, or by the use of hundis, it is necessary to establish in all parts of the country godowns and warehouses; the receipts given by them can be used as credit instruments to obtain accommodation cheaply from the money market. They will also give the sellers of produce greater freedom to keep it from the market until a fair price can be obtained. It is true that the cultivators object to the pooling of their produce, but the objection can be gradually overcome, and they can be made to appreciate the gains from standardization, grading and pooling by means of education, propaganda, and the operation of warehouses in selected centres.

The Central and Provincial Banking Committees have, therefore, recommended that the Provincial Governments should take up the question of giving long-term loans at low rates of interest to co-operative societies to construct godowns in centres which provide good markets, as the Government of Madras has started doing, and also of providing warehouses through private agencies, and licensing them, and giving loans for their construction; and that the Imperial Council of Agricultural Research should co-ordinate this activity of the Provincial Governments. One or more licensing Boards consisting of the representatives of Government, local business interests and agriculture, should be established in each province for granting licences to warehouses. Those who are licensed as warehousemen should be persons of recognized integrity, substantia capital, and business ability, and should be made to employ trained graders certified by Government to grade the produce. Further, the Central and Bombay Committees have recommended that the railways also should examine the feasibility of establishing and working warehouses in selected centres, or of allowing private agencies to do so, in the immediate neighbourhood of railway stations, and giving them all reasonable facilities.[1]

Finally, the railway receipts that are either attached to hundis or sent direct to the consignees are not negotiable, do not give a full and correct description of the goods, and do not supply safe security to banks by being endorsed in their favour, as bills of lading do. The Central Banking Committee, therefore, has suggested the removal of these defects by legislation so as to make the receipts more useful in financing the marketing of goods.

1 See Bombay Committee Report, p. 114.

Chapter III

RURAL FINANCE : CO-OPERATIVE AND LAND MORTGAGE BANKS

1. *Co-operative credit useful only for short-term needs of agriculturists.*—All authorities, including the provincial and Central Banking Committees, and the Foreign Experts associated with the Central Committee, are agreed that co-operative credit institutions can supply only the short-term and intermediate credit needs of agriculturists with safety and success, and not their long-term needs.[1] The reasons are as follows:—

(1) The resources of these institutions consist mainly of deposits and loans obtained for short periods, and not of share capital and reserves, owing to the limited means of their members, and it is dangerous to use such resources for long-term loans.

(2) Long-term loans can be given only against the mortgage of land, but the substitution of mortgage for personal security may lead to the neglect of co-operative principles.

(3) The enquiry and valuation, that must precede the grant of long-term loans, can be conducted only by trained experts, who must be controlled by a central organization and they are not available to the ordinary credit institutions.

(4) Many of these institutions cannot be relied upon for the safe custody of valuable documents and title deeds relating to mortgages.

(5) Their assets will get frozen, if the long-term loans are not repaid when they become due, as the acquisition and execution of mortgage decrees are very difficult.

The reports of the Provincial Committees show that there has been no reduction of the total rural indebtedness through the agency of co-operative credit institutions. Long-term credit can be supplied to agriculturists, with any degree of safety and success, only by land mortgage banks, which can obtain the bulk of their resources by issuing debentures.[2]

1 See Foreign Experts' Report, Central Committee Report, p. 697.

2 *Cf.* Foreign Experts' Report, attached to Central Committee Report, p. 691.

2. *Progress of the co-operative movement.*—We shall deal first with the growth of co-operative credit institutions and then with land mortgage banks. Co-operation may be defined as a voluntary organization of persons, who associate on equal terms to fulfil their economic needs and to promote thrift and self-help among themselves.

Co-operative credit is the simplest and the most urgently needed form of co-operation, and the development of this movement in India has been mainly confined to this form. Its growth may be divided into three periods. The first began with the passing of the Act of 1904, which officially launched the movement in India. The Act freed co-operative credit societies from the elaborate provisions of the Indian Companies' Act, laid down a simple business procedure for them, and provided for the establishment of a Co-operative Department in each province under a Registrar for the guidance of the movement. It, however, did not provide for the registration of more complex and central institutions, like central and provincial co-operative banks, that are needed for financing and controlling the primary credit societies, and also of non-credit societies dealing with co-operative production, sale, purchase, insurance, etc. During this period, therefore, the movement was confined entirely to credit and remained in its infancy.

The above-mentioned drawbacks of the Act of 1904 were removed by the Act of 1912, which ushered in the second period. Progress was better during this period, especially as the Maclagan Committee on co-operation examined the movement and made many valuable suggestions in 1915 for improving it. The third period commenced with the passing of the Government of India Act of 1919, which made co-operation a transferred provincial subject in charge of a Minister. The Act of 1912 has been replaced by Provincial Acts in Bombay, Burma and Madras since 1925, 1927 and 1931 respectively. In the early part of this period, the number of societies was much increased. More recently, however, greater attention has been paid to the consolidation and strengthening of the existing societies than to the creation of new ones. During this period also valuable suggestions for the development of the movement have been made, after survey, by the Agricultural Commission and Provincial Enquiry Committees in various provinces.

In 1959-60 the latest year for which figures are available, the total number of co-operative institutions in the Indian Union was 3,13,499 made up of 22 State (Provincial) Co-operative Banks, 400 Central Banks 2,03,172 primary agricultural credit societies, 11,371 primary non-agricultural credit societies, 9,554 grain banks, 88,556 State non-credit societies, 16 central land mortgage banks and 408 primary land mortgage banks. The total number ofmembers of primary agricultural credit societies, primary non-agricultural credit societies and non-credit societies was 144.42 and 102 lakhs respectively. Assuming that a family had five members on the average, this membership meant that 1515 lakhs of people or about 38 per cent of the population benefited from the co-operative movement in India respectively.

The total working capital in the movement was Rs. 1083 crores. The movement, however, has made different progress in different States. It has been more successful in Madras, Punjab, Maharashtra, Mysore Kerala, Andhra Pradesh and Utter Pradesh than in other States. This is shown by the following figures :—

	Number of members of primary societies per 1,000 inhabitants
Andhra Pradesh	86
Assam	41
Bihar	33
Gujarat	82
Jammu and Kashmir	59
Kerala	94
Madhya Pradesh	39
Madras	106
Maharashtra	93
Mysore	93
Orissa	69
Punjab	101
Rajasthan	39
Uttar Pradesh	86
West Bengal	60

But in judging the progress in different States, more important than the number of societies and members is the consideration of how far the societies are working on truly co-operative lines and how far they have improved the economic conditions of their members and the families of the members. Applying this standard, it becomes clear from the reports of the Provincial

Banking Committees and the annual reports on the working of co-operative societies in different States that the movement has made better progress in Maharashtra, Punjab, Madras and Mysore States than in other States. The chief reason for this is said to be that the agriculturists of these States have as a rule mortgagable rights in their land and can, therefore, offer real, instead of personal, security for obligations incurred by them. Those of the other States can offer personal security only, as they are mere tenants holding their land from landlords.[1]

Applying the two tests of the proportion of the rural population that has benefited from it, and the proportion of the rural financial need supplied by it, the progress of the movement must be pronounced to be disappointing in the country, especially in the States other than Maharashtra, Punjab and Madras. The report of the Rural Credit Survey Committee also makes it clear that the financial facilities provided by the movement to the rural population supply a small part of its needs. This is due to several prominent defects in the working of the movement, and these will be examined later.

3. *Intrinsic advantages of the co-operative movement.*— In spite of these disappointing results the movement cannot be condemned as useless, because there cannot be any doubt about its intrinsic advantages. "A scheme of Government or joint-stock bank finance might reduce the rates of interest, but only co-operation can teach the peasant to borrow at the right time, and in the right amounts and for right ends, and to repay on the right dates; and only co-operation can teach him to save so that he may not have to borrow at all."[2] The movement has proved most beneficial, economically, socially and educationally, not only to a large proportion of the populations of several Western countries, but even to the members of those co-operative societies that have proved successful in India on account of efficient management, and to their families.

They have obtained substantial funds, especially for short-term and intermediate credit needs, at reasonable rates of interest, and have saved much in interest charges. They have obtained improved varieties of seeds and manure, and more efficient implements at reasonable prices, and improved the

1 See India in 1927-28, pp. 375-6 and Jain : *The Monetary Problems of India*, pp. 74-5.

2 The Punjab Committee Report, p. 103.

breed of their cattle, and thus improved their agriculture. They have secured better prices for their produce. Their thrift has been encouraged. They have received practical training in the handling of money, in business matters and in elementary banking principles, and have learnt to keep accounts, to sign pronotes, and to read pass-books and receipts. They have influenced each other's conduct, have checked bad habits, such as indulgence in drink or gambling, and fostered self-restraint, discipline, self-respect, and punctuality.

The hold of the money-lenders over them has been loosened and this has produced a marked change in their outlook. They have started schools, provided scholarships, improved sanitation, and established benefit funds. In short, the corporate village life, weakened by modern disintegrating influences, has been revived in those villages in which co-operative societies have been working satisfactorily, and the same desirable development can gradually be brought about in other villages by the spread of co-operation on the right lines.

The Agricultural Commission expressed the opinion that the financial solvency of the movement was beyond dispute, and that it was the working of the societies that was defective. The Provincial and Central Banking Committees agreed with this statement. The reports of the Provincial Committees showed that the further expansion of the movement was temporarily suspended for the purpose of consolidating it and promoting its financial soundness and stability.[1] The economic depression and fall of commodity prices created much economic distress among agriculturists, and increased the arrears and overdues of co-operative credit societies. Coercive action against defaulters proved to be no remedy, because it merely saddled societies with lands which were difficult to manage and dispose of. Further, debt legislation adversely affected the working of many societies, because, in many provinces, a member owing a debt to his society could file an application before the conciliation board for its reduction and suspend payment of his instalments, until an award was made by the board and approved by the Registrar. At the end of 1938-9, 9 per cent. of the total number of existing societies were in the process of liquidation, and 40 per cent. of the societies in four provinces, and 25 per cent. in three others, fell in D (bad) and E (hopeless) classes. In some

1 See Bombay and Assam Committees Reports, pp. 162 and 150 respectively.

provinces such as the Central Provinces and Berar, Bihar, Orissa and Bengal, the movement nearly collapsed. But the weathering of the storm by the movement in the country as a whole, with a fair measure of success, until the prices of agricultural produce began to rise from 1941, showed the inherent soundness of the movement, and with the turning of the tide, schemes for the rehabilitation and reorganization of the movement were adopted in various provinces.[1] The movement showed better results towards the end of the war. It played a useful part in the settlement of the demobilised servicemen in civilian occupations, in the rehabilitation of innumerable persons displaced by the partition of the country and in the distribution of essential food articles and consumers' goods. Further, co-operation has come to occupy an important place in the Five Year Plans of the Central and State Governments in the Indian Union. Nevertheless, every year, the number of societies under liquidation is between 15 and 16 thousand.

Organization and working of primary societies.—To proceed to the working of the co-operative machinery, which consists of the primary societies, central banks and state banks. The apex of the co-operative organization in a state is the state bank to which central banks are affiliated. The primary societies are mostly affiliated to the central banks. Some of them are grouped into local unions for purposes of supervision. All of them are forbidden to lend to non-members except with the sanction of the Registrar of co-operative societies.

The primary society is an association of borrowers and non-borrowers who, residing in one locality, know one another, and take interest in one another's affairs. Membership is open to any inhabitant of the same locality who, in the opinion of his fellow-members, possesses a good character, regardless of his caste, creed, or calling. This brings together persons of different status into a common organization, and promotes a true spirit of co-operative brotherhood. As the movement is essentially moral and individualistic, rather than socialistic, the Registrar registers a society only when he thinks that its prospective members understand co-operative principles and duties. The operations of each society are restricted to a small area, a village, to enable its members to know each other and to watch each other's doings, to prevent the domination of one man, to bring more men to the front, and to facilitate supervision and training.

1 See Review of the Co-operative Movement in India, 1939-40, pp. 7-9.

Rural credit societies are generally organized on the Raiffeisen model, named after the famous German co-operator, with unlimited liability of members. Unlimited liability provides a good foundation for rural credit by giving better protection to the creditors, and supplies the best incentive to the members of a society to be careful in the selection of their fellows, to select the most competent officers, to be careful in giving loans, to watch the members to whom loans have been given and to be strict in demanding their prompt repayment on the stipulated dates. The tangible assets of a society consist of the property owned by its members, the details of which must be mentioned in the 'property statement' of the society. Its efficient working depends largely upon the careful preparation and periodical revision of this statement. Some of the urban credit societies are on limited liability.

In some localities members contribute a small share capital, in others they do not. In the former, the rate of dividend and the maximum value of the shares that a single member can hold, are restricted, and every member has one vote only regardless of his holding of shares. The right of a member to transfer or charge his shares is rigidly restricted, and they are exempted from attachment or sale by courts, or in insolvency proceedings. A committee of management, president and secretary, rendering services honorarily, are elected annually and controlled by the general body of members. The general body, however, must take a practical interest in the society's business, which must be transacted with maximum publicity.

The societies have a prior claim, with the exception of that of Government dues, over other creditors of their members, in respect of enforcing their outstanding demands on members for loans given to the latter for agricultural requisites.

The funds of the societies are derived from share capital, if any, deposits of members and sympathisers who are non-members, and loans from central banks. Deposits imply thrift, and they interest in the management of the societies men who stand as sentries over their own deposits. Hence, the societies aim at getting as many local deposits as possible at reasonable rates of interest. They have, however, been much hampered in realising this aim by the high rates that can be earned from trading or private lending. They avoid attracting deposits from areas served by other societies or from the clientele of

central banks. The maximum borrowing power of all societies is fixed at a definite fraction, varying between one-fourth and one-eighth in different States, of the value of the net assets of all the members composing them, and no society can borrow in the shape of deposits and loans, beyond this maximum.

The maximum power of individual members of borrowing from the societies to which they belong is fixed at a definite proportion, usually one-half, of their individual assets, and the loans actually given to them within this maximum depend upon the objects for which they need the loans and their repaying capacity. The societies cannot always insist on restricting the loans to productive objects because, by doing so, they would merely encourage their members to misapply loans given for productive purposes, or to resort to money-lenders. Moreover, other members take care that the borrowing members do not spend more money on unproductive objects than is strictly necessary. But loans cannot be given for speculative or wasteful expenditure. The objects of loans are cultivation expenses, the purchase of cattle, fodder and implements, the payment of land revenue, the repayment of previous debts, redemption of mortgages, personal maintenance, ceremonial expenses, and litigation.

Unproductive loans are given much less frequently, on a much smaller scale, and for shorter periods than productive loans. Misused loans are promptly recalled. The primary security for all loans is personal—the guarantee of the borrowers and sureties, but mortgage security is also frequently obtained. Sureties prevent the grant of excessive loans and their misapplication, and facilitate their recovery. Other members also watch the use of the loans and their repayment on the due dates. When the borrowers are unable to repay them and have a good reason, such as the failure of crops, the necessary extension of the period of repayment is given, and no undue pressure is exercised on the borrowers. The rates of interest charged are given in section 7 below in a separate table. They differ considerably in the various States, and within a State itself. Whether they are reasonable or not depends upon their relation to the rates prevailing in the outside local market.

The societies are compelled by law to build up reserve funds out of profits. In societies having no shares, the entire profit is credited to the indivisible reserve. In share societies also

the reserve fund is indivisible, and a substantial portion of the profit must be carried to the reserve fund. Some societies use their reserve funds to give loans to their members, others deposit them with the central banks. The Central Banking Committee has supported the latter practice as making for greater safety, and has recommended that the central banks should give loans to the societies at concessional rates up to the extent of the latter's reserve funds deposited with them.

5. *Organization and working of central banks.*—A central bank is a federation of primary societies in a specified area, one or more talukas, or tahsils, or a district, and is located at the headquarters of, or another important town in, a district. Some central banks have a few branches at other towns in their respective districts. It has two types: the first having a membership confined to societies and known as a banking union, and the second having a mixed membership of individuals as well as societies. The admission of individuals, mainly belonging to the middle class, is necessary in many cases at present because, although the representatives of the societies are usually given a large voice on the board of management of a central bank, they do not possess sufficient business capacity for its management, which is much more complex than that of a primary society, and cannot, therefore, inspire much public confidence. The managing board, therefore, contains some individuals of influence and business capacity belonging to the middle class. The central banks have consequently secured the confidence of the public, and play an important part in the Indian money market. The representatives of the societies are given a preponderating voice in their management. When the representatives develop sufficient influence and business capacity, the individual members of the central banks can be eliminated gradually, and the conflict of interest between their shareholders and borrowing societies can be removed by the identification of both the parties.

The central banks finance the primary credit societies, balance the excess and deficiency in their resources, but do little commercial banking. The primary societies should not lend to one another, as this interlocking of liabilities is dangerous to them. The number of the shares of the central banks that an individual can hold is restricted, their dividends are limited to 10 per cent. and their liability is limited. Their resources consist of the

share capital and reserve fund; deposits of various kinds, such as current, fixed, recurring, prudent, provident and savings, obtained chiefly from professional men, land-owners and other sections of the middle class—a new source which is being tapped by them with hardly any competition with joint-stock banks; the deposit of the surplus funds and reserve funds of primary societies affiliated to them; loans and overdrafts from the State Bank and a few joint-stock banks ; and the deposit of surplus funds of municipalities, local boards, Universities and other semi-public bodies in some States, in which the central banks have built up a high reputation for stability.

They lend funds to affiliated primary societies, within the limits of the borrowing capacity fixed for each, and on the same principles of co-operative credit as those mentioned above in dealing with the primary societies. The period for which they give loans to the societies depends upon the period for which they get their funds. Their lending rates have to be nearly 3 per cent. higher than their borrowing rates, to cover expenses, to build up a reserve fund, and to pay a moderate dividend. They maintain a staff of inspectors, who examine the affiliated societies' statements of assets and normal credits, watch over the use of the loans and the progress of recoveries, and keep the banks in touch with the working of the societies. Twenty-five per cent. of their net profits must be carried to the reserve fund. They have also to keep sufficient liquid resources in the shape of cash balances, unutilized cash credit with the State Bank and Government promissory notes, to pay the claims of depositors.

To provide for the losses that may be caused by the inability of some of the primary societies to repay the loans given to them by the central banks, the Central Banking Committee has proposed that the latter should build up a bad debt fund with a portion of the annual profits, in addition to the reserve fund. To increase the protection of their depositors and the confidence of the public in them, the Committee has suggested that the limited liability of their shareholders, consisting of societies, but not individuals should be coupled with a reserve liability restricted to the face value of the shares that they hold.

6. *Organization and working of State (Provincial) Banks.*—In all the States, central co-operative banks have federated themselves

into apex banks called state co-operative banks. Their share capital is provided partly by the affiliated central banks, and partly by individuals. The latter play an important part in the management of the state banks, as it is even more complex than that of the central banks, and requires expert banking knowledge, but they should not be given a preponderating voice in the management.

The banks are managed on ordinary business principles with due regard to the needs of co-operation. They tap the resources of the richer urban classes, in the form of deposits, which are not available to the central banks, link up the co-operative organization with the money market and the commercial banks, act as financing agencies to the central banks, and balance the excess and deficiency in the resources of the central banks. The latter should not lend to one another, as such interlocking of liabilities is dangerous to them.

State banks also serve as central banks in areas which have no local central banks of their own. The funds of the State banks consist of share capital, reserve fund, various kinds of deposits similar to those of the central banks, short-term loans, cash credits and overdrafts from the State Bank of India and some of the joint-stock banks, and the deposit of the surplus funds of the central banks affiliated to them. Some of them also lend their own surplus funds to one another. They lend to the primary societies, not direct, but through the affiliated central banks, except in areas which have no central banks of their own. Funds thus flow from the State banks to the central banks, then to the rural societies, and finally to the individual borrowers.

The state banks have no powers of control or supervision over the central banks, except what they may exercise as a condition of granting loans. Such control or supervision is practically non-existent at present. Nevertheless, in some States they have, with their efficient staff, played an important part in developing the movement on sound lines, especially in areas in which they finance societies direct. They have also formed the Indian State Co-operative Banks' Association to co-ordinate their work, to promote common interests, and to supply information regarding each other's financial needs. As the Reserve Bank has stated that it can help them only to tide over a temporary shortage of funds and cannot supply them with

normal finance, they will have to consider the question of starting a separate apex bank, when their present surplus of funds disappears.

In addition to this association, there is the All-India Co-operative Institutes' Association, which promotes co-operation through member institutes, that have been established in different parts of the country, by supplying them with advice and assistance on all co-opertive problems.

The Co-operative Societies Act has made special provision for the audit of the primary societies, and the central and provincial banks. It has laid down that in each province the accounts of all of them must be audited at least once every year by persons authorized by the Registrar, and that the audit must include an examination of their overdue debts, if any, and a valuation of their assets and liabilities.

7. *Rates of interest in the co-operative organization.*—The rates of interest prevailing in the movement are appreciably lower in Maharashtra, Madras and the Punjab than in the other States. In the former States they are as follows :—

Primary Societies			Central Banks		State Banks	
Rate charged on loans to members. Per cent.	Rate paid on deposits. Per cent.	Rate paid on Central Banks on loans. Per cent.	Rate paid on deposits. Per cent.	Rate paid on State Co-operative Banks on loans. Per cent.	Rate paid on deposits. Per cent.	Rate on accommodation from the Reserve Bank. Per cent.
7 to 8	4 to 5	5 to 6	3 to 4	3 to 4	3 to 4½	1½ to 2 below bank rate

We have seen above that non-credit co-operative societies have made some progress in India, but that it is small as compared with that of the credit societies. An examination of their organization and working is beyond the scope of these pages, as they have no direct connection with banking. The Agricultural Commission and the Provincial and Central Banking Committees have recommended that the Provincial Registrars should encourage the development of these societies in the larger economic interests of the masses, especially the agriculturists.

8. *Defects in the working of the organization.*—We may now proceed to consider the defects in the working of the movement that have been mentioned by the Agricultural Commission, the Provincial and Central Banking Committees, witnesses before them, and others. They are as follows :—

(1) Official control is excessive, although the avowed policy of Government is to encourage non-official administration as far as consistent with its ultimate responsiblity to secure the progress of the movement on sound lines. This has tended to make the working of the movement mechanical, and to check the development of a sense of responsibility among the members.

(2) The inability of the Credit Societies to supply the short-term and intermediate as well as the long term credit needs of agriculturists has not been appreciated, and efforts have been directed towards making them supply all these needs.

(3) The understanding of the principles of co-operation and the knowledge of the essentials of rural credit are lacking among a large proportion of the members. The essence of the movement is that its members must learn to manage their own affairs. The task of teaching illiterate peasants to do so is a slow and elaborate process. But the supreme importance of educating and supervising them has not been adequately realised, and the desire to produce quick and extensive results has hampered the real progress of the movement.

(4) Both the official and non-official co-operative staffs are, in many cases, handicapped in their work by a lack or deficiency of training.

(5) The audit is defective, and does not conform fully to the statutory requirements.

(6) On account of the above defects, control over the operations of societies is defective. Many managing committees are inefficient, display a factious spirit, are not properly controlled by the general body of members, and appropriate too large a proportion of the loans for themselves. Members are frequently selected without care. Loans are sometims given to members recklessly, and their periods are extended without proper reasons. Short—term, intermediate and long-term loans are not clearly distinguished. Accounts are not always correctly maintained. The statement of the assets of societies is not always revised carefully from time to time, and the assets which remain in the

possession of members are sometimes frittered away by them, or used by them in connection with outside creditors. Members delay repayment of loans even when they are able to pay. Office-holders neglect taking action against defaulters. Consequently, the overdues of many societies are highly excessive. There is reluctance to liquidate societies even when their condition is beyond repair.

(7) Control in some societies has passed into the hands of a few powerful men, with the result that the interests of small producers are sacrificed to those of their more powerful colleagues. Similar concentration of control in some central banks has led to the overfinancing of societies to keep up dividends, the retention of high interest on deposits, and the receipt of superfluous deposits.

(8) Co-operative finance is often inelastic, dilatory, and inadequate, largely owing to the inefficiency or selfishness of managing committees. Members have to put up with much personal inconvenience and delay before they can obtain loans from the societies, and even then they may not get sufficient money for their requiremens. Many of them, therefore, have to obtain a part of their finance from money-lenders. Some societies, on the other hand, borrow as much as they can from the central banks once a year, and lend the money immediately to their members in lump sums, in the hope that the latter will make it last for the whole year. But the members manage to spend the whole of it as soon as they get it, and when other needs arise, they borrow money at high rates from the money-lenders. Many members also prefer the more accommodating policy of the money-lenders, who do not insist on punctual repayments, forgetting its ultimate consequences. The result is that in many localities the co-operative societies and the money-lenders exist side by side, and that the cultivators use both of them according to their convenience.

(9) Central banks have tended to work in isolation, and there is no co-ordination of their activities.

(10) The credit suplied by the co-operative organization, is too costly in some States. This is inevitable to some extent, because two or three intermediate agencies, *viz.* the primary society, the central bank and the state bank, need for their working expenses the difference between the rate of interest at which money

is obtained for the movement from outside and that at which it is lent to the borrowing cultivators. Conditions are ideal when the primary societies obtain locally all the funds needed for financing their members, chiefly in the shape of the deposits of members resulting from their practice of thrift. But the actual conditions in India are much more distant from this ideal than in other countries. The majority of the primary societies, except in a few States, are almost entirely only agencies for the distribution of funds obtained from the central and state banks, instead of being the 'savings and loans' banks of their villages and balancing centres for the demand for and supply of money.

Unfortunately the above defects have continued to exist to a substantial extent, although they were pointed out three decade ago.

9. *Suggestions for removing defects.*—The Agricultural Commission, provincial committees on co-operation, the Provincial and Central Banking Committees and the Foreign Experts made the following suggestions for removing these defects :—

(1) Official control of the movement should be lessened. The primary functions of the Co-operative Departments should be education, supervision and the control of audit, and the financing agencies should be made entirely responsible for internal working, loans and deposits. There should be more self-administration and self-responsibility for the primary societies according to the co-operative idea. This would make the movement more popular in the country, and promote a sense of responsibility among its members.

(2) The primary societies should be restricted to the finance of the short-term and intermediate credit needs of the agriculturists, and a separate organization, *viz.* land mortgage banks, should be set up for supplying their long-term needs.

(3) Special steps should be taken by the Co-operative Departments and the Institutes for the efficient and adequate training of the official and non-official co-operative staff. Trained secretaries should be secured for the primary societies as far as possible. The experience of other countries shows that school teachers and retired officials living in villages would prove very useful for this purpose.

(4) The co-operative staff should make more persistent efforts to promote the understanding of the principles of co-operation

and the knowledge of the essentials of rural credit among the members of the societies, and Government should spend more on the provision of such education. The Registrars should be more strict in registering the societies and should not register them until they are convinced that the prospective members really understand co-operative principles and duties. The efficiency of the societies in a State, and not their number, should be regarded as decisive.

(5) For the efficient audit, supervision and inspection of the societies, district unions should be formed of the primary credit and non-credit societies and central banks located within their areas, and should be registered under the Co-operative Societies Act. The managing boards of the unions should be composed of the representatives of the affiliated societies and a few specially trained Government officials. Their staff should consist of persons licensed by the Registrar, who should be empowered to cancel any licence for adequate reasons, but who must not be allowed to interfere in the internal management of the union. The unions should also supply practical training to candidates for appointment on the auditing, supervising and inspecting staff of the co-operative organization.

They should work in close co-operation with the central banks, should interchange with them reports and statements on the primary societies, leaving the central banks to arrange only for such inspection of the societies as may be necessary to protect their financial interest. The district unions should be federated into a separate State Union whose main work should be the supervision of the district unions, and the audit of the central and state banks.

(6) At the time of granting loans, the credit societies should carefully scrutinise the economic purposes of the loans and the repaying capacity of the borrowers. Loans should be granted to members of the managing committees only at meetings of the general body of members, supervisors should note at inspections whether they have obtained disproportionately large loans and, if so, the central banks should take this matter into consideration at the time of granting new loans to the societies.[1] The period for the repayment of all loans should vary according to the respective needs of the borrowers, but should not exceed three years. Extensions for repayment should be granted only

1 See Bengal Committee Report, p. 153.

if the borrowers are in exceptionally difficult conditions, and no tenderness should be shown in dealing with defaulters. If the managing committee of a society gives loans in excess of the limits laid down by the by-laws of the society, or otherwise, the committee members should be held personally liable as guarantors of the loans.

(7) Members of the societies should be taught the necessity of getting rid of unsatisfactory or dishonest office-bearers or committee members.

(8) The property statement of the societies should be prepared with great care and should be kept up-to-date.

(9) Special steps should be taken to eliminate all differences in the status of the members of the societies, and to avoid the danger of the control of the societies and central banks passing into the hands of a few powerful members.

(10) The normal credit system should be introduced in all societies. According to this system, each society has to fix the credit limit of all its members before the commencement of each season, and to arrange for the necessary finance in time, largely in the form of cash credits in central banks. The amount then would remain available to the society, and members can draw upon it, as and when they need money, and pay interest only from the time the money is drawn. Every central bank should take special care through its inspectors to see that its constituent societies fix this credit limit for their members properly and at the right time. Applications for crop finance can be made and sanctioned beforehand. The grant of credits on current account and cheque transactions should be introduced wherever possible, as this also will help to check the evils of inelastic and dilatory co-operative finance.

(11) To bring about a reduction in the rate of interest charged to the ultimate borrowers, the central banks should borrow urban money at lower rates for short-terms, and especially during the slack season, and should reduce their working expenses in those States in which they are excessive at present. The societies should also make strenuous efforts to become self-supporting by tapping the savings of the public direct, instead of through the central banks. Moreover, the profits of the co-operative societies and banks, already exempt from income-tax, should be exempted from super-tax also,

and their earnings from investments in Government securities and land mortgage debentures should be exempted from both these taxes, to the extent that such investments are needed for the purpose of their liquid resources and for the investment of their reserve funds as laid down by the rules. Further, they should be exempted from court fees as they are from stamp duties. The benefit of these concessions must, however, be passed on by these institutions to the ultimate borrowers in the shape of a reduction in the rate of interest charged to them on loans.

(12) The co-operative societies and banks should endeavour to collect savings deposits and encourage savings in years of plenty for use in periods of scarcity.[1]

(13) The state and central banks should be managed by persons well-trained in banking and co-operation, in accordance with business principles adjusted to suit the special needs of co-operation, and the latter should conduct all money transactions with the primary societies by means of cheques in order to speed up their activity.

(14) To stimulate the societies to improve their working, particularly as regards recoveries, the central banks should charge lower rates of interest on loans given to sound societies than on those given to societies less sound.

(15) There should be fullest co-operation between the Agricultural and Co-operative Departments.

(16) Capital at concessional rates should be made available to the societies and central banks for the construction or purchase of godowns in rural areas, for the purpose of stimulating the financing of the marketing of crops on a co-operative basis.

In its statutory report on agricultural credit submitted to the Government of India at the end of 1937, the Reserve Bank made the following suggestions for rectifying and consolidating the co-operative movement :—

(1) The overdues and long-term loans of primary societies should be separated and placed on a proper footing. The overdues should be brought down to a level at which there would be reasonable prospect of repaying them out of the profits of agriculture within twenty years, partly by writing them off

1 See the U.P., Punjab, Madras, and Central Areas Committees Reports pp. 187, 112, 241 and 240 respectively,

from reserve and other funds, and partly by recovery from sale of a part of the member's assets, and spreading out the remainder into instalments and transferring them to a special agency like a land mortgage bank. Even if the funds of a society are not sufficient to cover the losses, the best course is to decide what agency can best bear the losses. Liquidation of the society is no solution, as even after selling up the members, the society may be saddled with land, and its losses may still be left uncovered.

(2) Primary societies should build up strong reserves by keeping an adequate margin between their borrowing and lending rates, so as to be able to grant extensions or remissions to members in case of crop failures, and to prevent themselves from going into liquidation or a state of suspended animation.

(3) Primary societies should mostly restrict their loans to sums which members can repay from the proceeds of the next harvest, and loans given for 2 or 3 years for the purchase of cattle and implements should not form more than a small proportion of the societies' business. Loans given for purposes, which are not productive but are absolutely necessary, should be reduced to a minimum, and should not exceed the borrowers' paying capacity.

(4) They should be reconstructed on sound co-operative lines, so as to be not merely agencies for supplying finance, but also an influence for the all-sided development of agriculture and the betterment of the life of the cultivators from all points of view.

(5) They should be federated into small banking unions for purposes of finance, supervision and education.

(6) They should take up co-operative marketing and should aim at selling the produce of members in bulk, ensuring uniformity of quality by supplying approved seeds to the members. They should be assisted by Government and land mortgage banks with long-term advances for building up inexpensive but serviceable godowns for facility of collection. Only after such organizations have proved successful, large central sale societies should be organized to undertake the more difficult tasks of grading, processing, stablising prices by orderly marketing, and providing against losses by hedging, straddling and similar operations.

(7) If the number of societies affiliated to a central bank is so large as to make its working unwieldy, there is greater need for the societies to be grouped into banking unions. The state co-operative banks should play a large part in the direction, guidance and reorganization of the co-operative movement. Moreover, both central and state banks should be reorganized on commercial banking lines. They should maintain sufficient fluid resources to provide for the withdrawal of deposits. They should build up adequate reserves by maintaining a sufficient margin between their borrowing and lending rates. They should make stricter provision for setting out overdues in their balance-sheets, which should be uniform, prepared in such a way as to present a true picture of the condition of the banks, and published punctually. Finally, they should establish closer contacts with commercial banks of standing and make greater use of the latter for investment of their surplus funds and for obtaining credit from them on Government paper or otherwise. The latter on their part should use the former for the collection of bills in small places where they have no offices.

10. *The general scheme of the rehabilitation and recorganization of the co-operative movement.*—The outline of the scheme, which varied in detail in different States according to local conditions, were as follows :—The loans due to societies were to be scaled down to the paying capacity and assets of the borrowers, and the reduced amounts were to be repayable in instalments within a period not exceeding 20 years. The lands of borrowers that came into the possession of societies, in default of payment of dues, were to be returned to the original owners on the hire-purchase system. The lands of borrowers, not already transferred to the society, were to be transferred. The instalments of the loans fixed were to be regarded as instalments of the hire-purchase of the lands, and when the final instalments, together with a nominal amount of purchase money, were paid, the lands were to be re-transferred to the borrowers. The societies were to write off bad debts from their paid-up capital and reserve fund, and if their realisable assets were less than their liabilities, the central banks, which had financed them were to reduce their claims proportionately.[1] Similarly, the central banks were to write off their bad debts from their capital

1 See Review of the Co-operative Movement in India, 1939-40, p. 1.

and reserves, and if their realisable assets fell short of their liabilities, they were to induce their creditors, to reduce the latter's claims proportionately, and to pay a part of the claims in cash, and to convert the rest into debentures. Those societies which were in too bad a condition for reconstruction, were to be wound up without delay. The retained members of reconstructed societies were to be supplied with fresh finance, in kind as far as possible, for cultivation and other expenses, on a controlled basis of repayments in kind. Each loan was to be recovered out of the income obtained from its application. Through a co-ordination of the work of credit societies, central banks, sale societies and land mortgage banks, credit was to be linked up with marketing, and every stage of the application of the loan, from cultivation to the sale of produce, was to be supervised and controlled. For this purpose some Provincial Governments gave financial help through the provincial banks. In Bengal and Bihar, many crop loan societies were established for supplying this finance to agriculturists. Further, some Provincial Governments gave financial assistance to provincial banks to enable them and the central banks to meet losses under the reconstruction scheme.

The above attempts at reconstruction and rehabilitation have been accompanied by those at reorganization of the movement. Formation of crop loan societies, mentioned above, is one such attempt. Another has been the conversion of the credit, *i.e.* single purpose societies into multi-purpose societies for the gradual but all-sided development of agriculture and improvement of the entire life of the villager, because many authorities, such as the Reserve Bank, conferences of Registrars of co-operative societies and special committees on co-operation, have felt that the greatest weakness of the co-operative movement in India has been the exclusive or excessive emphasis laid on the credit side alone. The chief weakness of the credit societies is that they cannot keep in touch with the borrowers, from the time when loans are given to the latter, until the loans become due. The multi-purpose societies are meant precisely to establish that close and continuous connection, and to encourage that constant consultation between members and societies, which is necessary for the good of both, and which accords with the true co-operative spirit and promotes it. Starting with credit, such a society may get the old debts of its

good members liquidated through a land mortgage bank, induce its members to sell their produce co-operatively and realise higher prices for it, improve their crop production by consolidation of their holdings and supplying them with better varieties of seeds and improved implements, arrange for the purchase of the goods required by them jointly and economically on an indent system without incurring any risks, increase their income by persuading them to take up subsidiary industries, and adopt by-laws by common agreement for reducing ceremonial expenditure, removing insanitary habits, providing medical relief, etc.[1]

Central banks should help the rehabilitation and reorganization of the societies affiliated to them by taking real interest in supervising and guiding their operations and helping them in training their members in the principles of co-operation and in the sale of the produce of members, purchase of their requirements, etc. A few central banks have already started doing this. Several state banks also are giving active guidance in the work of rehabilitation and reorganization.

On account of the rise in the prices of agricultural commodities from 1943 and the consequent increase in the purchasing power in the hands of the farmers, the condition of many societies have improved. Their overdues have become less, assets have been liquefied, deposits have increased and reserve funds have been built up. The organization of new societies, therefore, has been taken up again, at places where conditions are favourable, after careful preliminary enquiry and with proper safeguards. This is not incompatible with the policy of rehabilitation, consolidation and improvement that will have still to be continued for some more time.

11. *Relations of the co-operative organization with other parts of the banking system.*—We shall now turn to the relations of the co-operative organization with the other parts of the banking system. The credit societies have been offering strong competition to the money-lenders and indigenous bankers. The deposit rates of the latter are much the same as those of the well-established co-operative banks, but they cannot enjoy as much of public confidence as the banks which are under the protection of Government. The competition has not, however, created any ill-feeling between the two. Many indigenous bankers act as treasurers or directors of co-operative banks, keep a portion

1 See Review of the Co-operative Movement in India, 1939-40, p. 21.

of their funds on fixed deposit with the banks, and keep a portion of the cash balances of the latter in current account with themselves. The very existence of some of the banks has depended upon the support of the indigenous bankers.

The various state and central co-operative banks get cash credit and overdraft facilities from the State Bank of India against Government and other authorized securities, and demand promissory notes of borrowers and the credit societies. The Reserve Bank gives them the facility of remittance of funds for co-operative purposes free of charge, and for other purposes at a small charge, between centres at which it has offices, and the State Bank of India does so between other centres where it has branches.

We shall examine in Chapter XII, section 4, the financial assistance which the Reserve Bank of India is authorized to give to the state co-operative banks, the relation of the Reserve Bank with these banks and the work of the Agricultural Credit Department of the Reserve Bank.

The activities of the co-operative banks and the commercial banks are so far apart that at present there is little competition between them. Allegations have, however, been made that the former, on account of the prestige supplied by the protection from Government, have been competing unfairly with the latter in attracting deposits. The reports of the Provincial Committees show that the allegations were not justified.[1] But recently, the rates of interest of deposits offered by the Co-operative banks are higher than those offered by those commercial banks, which belong to the Deposit Interest Rates Agreement. The Managing Governor of the Imperial Bank expressed the opinion before the Central Committee that the co-operative banks should be restricted to co-operative banking, and should not be permitted to compete with the joint-stock banks and the indigenous bankers by undertaking other banking work, such as the opening of current accounts, the purchase of drafts, and the sale of remittances, on the ground that they had neither the knowledge, nor the organization, that were necessary for transacting such business with safety.

Co-operators strenuously opposed this suggestion, and the Central Banking Committee agreed with them, and recommended that co-operative institutions should allow credit on current

1 See Bombay and Punjab Committees Reports, pp. 177 and 115.

account and cheque transactions wherever practicable, and that no restrictions should be placed on their remittance business.[1] The Assam Committee suggested that the provincial and central banks should make more use of the larger commercial banks by depositing with them funds for which they had no immediate need, and that *vice versa* the latter should lend funds to the former during the slack season, and the Central Committee supported this suggestion. The Burma Committee suggested that closer connection between the two should be striven for, and the Central Committee approved of this suggestion also.

12. *Connection of the co-operative organization with Government.*—In addition to the provision of a staff of officials under the State Co-operative Departments to direct the audit of the co-operative institutions, and to supervise and encourage their activities, Government has helped the movement by giving money grants or loans occasionally to certain societies or banks, by guaranteeing interest on long-term debentures issued by particular banks, and by giving certain general concessions, such as exemption from income-tax, stamp duty and registration fees, free transfer of funds from one co-operative institution to another for co-operative purposes, freedom of the shares or interest of members in the co-operative societies from liability to attachment by a court decree, and prior claim over other creditors in enforcing recovery of their dues in certain cases. Moreover, some State Governments advance tagavi loans to cultivators through the agency of primary credit societies.

The credit which the co-operative organization possesses in the money market is largely due to its connection with Government. In theory Government Co-operative Departments are responsible only for the audit, supervision and propaganda, but actually the responsibility has been carried much further in some cases. When the provincial bank in the Central Provinces suspended payment during 1920-1, Government gave financial assistance to a majority of the central banks in this province. The Bengal, Bihar and C.P. Governments gave grants to their provincial or central banks for meeting the losses incurred in financing societies during the Depression. Further, some Provincial Governments gave advances to their provincial banks, when the latter's resources became insufficient to meet the needs of the societies, owing to the catastro-

1 See Report, p. 148.

phic fall in the prices of agricultural produce. The position seemed to be that ordinarily Government did not undertake any financial responsibility with regard to the co-operative organization, but did so only in exceptional circumstances. The Central Banking Committee approved of this policy,and suggested that in the interests of the tax-payers, and to promote self-help among the co-operators, such aid should be given temporarily, with the concurrence of the legislatures, and just sufficiently to enable the co-operative organization to pass through a crisis, and that the aid should be given through the provincial banks.

The Committee of Direction, All India Rural Credit Survey, however, as seen below, has recommended state partnership in the strategic co-operative institutions as the only means of bringing about a satisfactory reorganization and rapid development of the co-operative movement. Many co-operators and State Governments have veered round to this new view. But they are confused by the declarations which have been made by some authorities that Government had erred in adopting the new policy of active State participation in co-operative institutions and by contrary declarations made by the same authorities at other times and by other authorities that Government is right in adopting the new policy.

Apart from maintaining enlarged co-operative departments to assist actively in the formation and development of co-operative societies, the State Governments now participate in the share capital of co-operative institutions, both credit and non-credit, grant loans and subsidies to marketing and large credit societies to build godowns and also subsidies towards managerial cost for credit, marketing and processing societies. They also guarantee debentures floated by land mortgage banks. They obtain aid from the Government of India and loans from the Reserve Bank for carrying out these objectives.

13. *Present Position of co-operative land mortgage banks.*— It has been explained before that the co-operative credit societies are not suited to the supply of long-term credit to agriculturists for the purchase of land or costly agricultural appliances, the improvement of holdings, the repayment of past debt, and the redemption of mortgaged land. Commercial banks and indigenous bankers also cannot supply such credit, because they cannot afford to lock up their capital for long periods, or to recover their loans in small amounts out of the earnings of the

borrowers. Such credit can be supplied only by a special type of credit institutions, known as land mortgage banks, which are either co-operative, semi-co-operative, or joint, stock.

In 1959-60 there were 91, 2, 24, 42, 7, 102, 9 and 12 primary land mortgage banks in Andhra, Assam, Maharashtra, Madras, Kerala, Mysore, Rajasthan and West Bengal respectively, with a working capital of Rs. 818, 15, 511, 792, 110, 392, 15 and 30 lakhs respectively. Although all of them have been registered under the Co-operative Societies Act, strictly speaking, they are semi-co-operative. They are limited liability associations of agricultural borrowers, with a few non-borrowers for obtaining initial capital and the business capacity that is necessary for efficient management. In some cases, members have to contribute to the share capital a certain percentage of their borrowings, but generally the shareholding of each member is limited, and he has a single vote whatever be the number of shares that he holds. Dividends are restricted, and the aim is gradually to eliminate the non-borrowing members. But the work of these banks lacks the personal and human elements which are the main features of co-operation, and the insistence is, not on the members' mutual knowledge of, or control over, one another, but on the business capacity of the management for the purposes of the correct valuation of security, careful enquiries into titles to land, and to correct determination of the credit and repaying capacity of the borrowers.

The working capital of these banks consists of share capital, deposits, and debentures which have been issued in some cases by themselves, in other cases by the state co-operative banks for their benefit with a floating charge on mortgages of land, and the interest of which is guaranteed, or a portion of which has been purchased, by Government in some cases. In Madras, Gujarat, Orissa, Andhra, Kerala and Mysore, as it was found that the issues of different debentures by a number of independent banks hampered their successful floatation, a Central Land Mortgage Bank has been established to finance primary land mortgage banks by centralized debenture issues, and also to inspect their working and to give them advice and help. Up to March 1960, the Madras, Andhra, Gujarat, Maharashtra, Orissa, Madhya Pradesh, Mysore, Assam and Kerala Banks had floated debentures guaranteed by Government to the extent of Rs. 685, 677, 590, 319, 52, 39, 304, 5 and 47 lakhs respectively.

Loans are given to members on the mortgages of their lands up to 50 per cent. of their value in some States, or up to 30 times the land revenue payable on them in others, after assessing the value of the lands, and determining the members' title to them, their right to alienate them, their need for the loans and their repaying capacity. A maximum varying from Rs. 5,000 to Rs. 10,000 has been laid down for the total amount that can be lent in this way to individual members. The period of the loans varies up to a maximum of 16¼, 20 or 30 years in different States, and the rate of interest charged varies from 6 to 9 per cent. Repayment of the loans has to be made either by equal annual instalments of principal, interest being calculated every year on the amount outstanding, or by equated annual instalments which include the principal as well as interest. Loans have been given mainly for the redemption of old debts and not for financing agricultural improvements, because relief from indebtedness to money-lenders has been the greatest need of the cultivators. The land mortgages obtained by the primary banks are assigned to the State banks as security for the loans advanced by the latter. As in some banks the managing committees were too free in granting loans to themselves and to their relatives, the grant of such loans has been either prohibited altogether or subjected to restrictions. Nevertheless, the number of defaults has been appreciable owing to bad harvest and imprudent loans. Since 1943, however, on account of the increase in the purchasing power in the hands of the farmers, their demand for loans from the banks has slackened.

The Governments of the States concerned have guaranteed the principal and interest of the debentures issued by their Central Land Mortgage Banks. Although the Reserve bank is not prepared to purchase them until they become easily marketable, it has declared them to be on a par with Government securities for the purpose of advances to scheduled banks under section 17(4) (a) of the Reserve Bank Act. Further, it keeps itself in touch with the banks through its Agricultural Credit Department and gives them advice. The above Governments have also granted the banks exemption from stamp duty, registration fees and income-tax and a temporary annual subsidy. They are represented on the boards of the apex banks by the Registrars and on the boards of the primary banks by nominees of the Registrars. In addition to primary banks, individuals are

allowed to become shareholders of the apex banks in order to secure the confidence of the investing pulic and strict adherence to business principles. To prevent dividend hunting, the by-laws provide that one-fourth of the net profits must be credited to the reserve fund, and that the dividend must not exceed 6½ per cent.

14. *Suggestions for organizing and working co-operative land mortgage banks.*—It is thus seen that co-operative land mortgage banking is yet not developed well in India. The problem of supplying long-term credit to agriculturists has been examined carefully by conferences of the Registrars of Co-operative Societies, the Agricultural Commission, and the Provincial and Central Banking Committes, and all of them are agreed that such credit can be provided to small agriculturists most suitably through co-operative land mortgage banks, because they cannot secure credit except through organizations based on mutual association, and the collective guarantee of their properties mortgaged by them. These authorities have, therefore, recommended that these banks should be registered under the Co-operative Societies Acts. They should be organized only after careful enquiries, and their constitution and working should be as simple as may be consistent with adequate safeguards. Their area of operations should be fairly small, consistent with competent management. Their management should be kept entirely separate from that of local credit societies. For some years, there should be a nominee of Government on their committees of management, except where the interest of Government and debenture-holders are adequately safeguarded by the appointment of a trustee acceptable to Government. Their dividends should be restricted until an adequate reserve fund is built up.

Their working capital should be obtained from two sources, *viz.* share capital and debentures. The liability of members should be limited to the amounts actually borrowed by them from the banks, plus their share money. The share capital can be obtained in two ways. The members may subscribe it before securing loans, thereby supplying a good basis of security to the debentures that will be issued by the banks later; or the share capital may be obtained gradually by deducting a certain percentage, not less than 5, of the loans given to the members, thereby increasing gradually the borrowing capacity of the banks also. To enable the banks to start with substantial resources,

the State Governments should, wherever necessary, give them interest-free advances on the condition that the advances are repaid out of the proceeds of debentures issued.

The greater part of their working capital should be obtained by issuing debentures. The value of outstanding debentures should never exceed the value of the outstanding mortgages given by the borrowers, on which the debenture-holders would have a floating charge. The best assistance that the State Governments can give the banks in the issue of debentures is to guarantee the interest on them for the entire period of their currency, and to include them among trust securities, after adequate arrangements are made by the banks for their redemption at regular intervals. The debentures should be issued, not by individual banks, but by a central institution in each State, which should be called the State Land Mortgage Corporation. Their actual sale, however, should be conducted both by the corporation and the primary banks. The latter should obtain funds from the former against a transfer of their mortgage securities, which would serve as the basis for the debentures. The State co-operative banks may finance the primary land mortgage banks with long-term capital specially raised by the issue of debentures, only until the State Land Mortgage Corporations are established in their States, but not afterwards.

The land mortgage banks should not be allowed to obtain deposits like the co-operative credit institutions. To develop the habit of thrift, however, among the borrowers, the banks may make them contribute annually a certain sum to a provident fund. The banks may be allowed after some years to accept deposits for not less than 5 years, and to issue savings certificates payable after 5, 10 or 15 years, but not at present, because they will have to give most of their loans for the first few years for long periods for the liquidation of old debts, so it will be dangerous for them to finance these loans with such deposits and certificates of much shorter duration.

The amount and period of loans should be determined with due regard to the objects for which they are to be given and the repaying capacity of the borrowers. The amount of loans to individual members should be limited to a maximum of Rs. 5,000 for the present, until the banks obtain better experience, and the amount of loans should never exceed 50 per cent.

of the value of the mortgaged properties. The maximum period of loans should be 20 years for the present, and may be extended to 30 years, if necessary, after the banks are soundly established. If the borrowers are also members of credit societies, they should be consulted before loans are given. Loans should not be given for purposes that are not economically profitable to the borrowers. They should be given principally for the redemption of the land and houses of agriculturists, the liquidation of their old debts, the improvement of their land and methods of cultivation, the building of houses, and the purchase of land in special cases only, in order to prevent land speculation and indiscriminate borrowing for the purchase of land.

Misapplied loans should be promptly recalled. Punctuality in the repayment of loans should be rigidly enforced by the banks. The repayment should be by a system of equated payments, thereby amortizing the loans within a definite period. The instalments need not exceed the amounts usually paid by borrowers to money-lenders in the shape of interest alone. For instance, an equated payment of 12 per cent. of a loan every year will provide for the regular payment of interest at 9 per cent. and for a gradual extinction of the principal of the loan within a period of 16¼ years. A system of graduated payments may be introduced, if local conditions need it, so as to provide for extinction by larger instalments, starting after the investment of the loan on the land has begun to yield an increasing profit. The by-laws of the banks should empower the management to enforce that method which it may regard as more suitable.

These banks should be given summary power of recovering their dues by the foreclosure and sale of mortgaged properties without having to resort to the civil courts, subject to three safeguards, *viz.* first, that the foreclosure must not be resorted to until the dues bear a substantial proportion to the value of the mortgaged property; second, that the interests of the mortgagor must be protected by preventing any contravention of the provisions of the Civil Procedure Code with regard to the sale of the mortgaged property; and third, that the aggrieved party must be given the right to question in the civil courts the action of the banks. If they are not vested with this power by special legislation, they will have to file suits in the civil courts for the recovery of their dues, and to resort to the elaborate provisions

of the Transfer of Property Act and the Civil Procedure Code for obtaining and executing mortgage decrees. This will not only hamper their operations but, by preventing their debentures from being a popular and liquid form of security, will also hamper their efforts to obtain a sufficient working capital by issuing debentures.

In its Statutory Report, the Reserve Bank has pointed out that owing to the almost exclusive attention that is being paid by land mortgage banks to the liquidation of old debts, they are running the risk of finding themselves ultimately in the same position as some of the credit societies, with their assets frozen. A cultivator who is habitually running into debt cannot be saved merely by the grant of longer instalments with lower rates or interest. He must be trained in the use of money, and his margin of profit must be increased. The present system of some banks of taking up debtors, without considering their fitness, and looking only to the security offered by them, is opposed to the true co-operative ideal. Experience has shown that security of land proves more an embarrassment than an asset when it has to be realized on a large scale. Hence even land mortgage banks must look more to the paying capacity of the debtors than to the mere value of their assets. Persons whose debts are to be paid by these banks should, therefore, be made to serve a period of probation with a good primary credit society, and even after the banks have advanced them loans, they should continue to be members of a multiple-purpose society, which will ensure regular repayment of their instalments by proper supervision of their activities. This co-ordination of the banks and credit societies will benefit the societies also, because they will be able to restrict their loans mostly for meeting the current expenses of cultivation of their members.

Further, land mortgage banks should pay increasing attention to the supply of finance for the improvement of land, which would be permanently beneficial to the agriculturists, as this ought to be the main purpose of long-term loans raised on the security of land. The banks should secure the help of the State Agricultural Departments for propaganda and education of the cultivators in the facilities offered for financing land improvements, for assistance to cultivators in preparing suitable schemes for financing, for examination of the technical aspects of schemes submitted, and for inspection of progress after they

have been put into operation.[1] The banks should also establish close contact with all other agencies working for the economic salvation of the villagers and take part in the work of rural reconstruction.

Finally, the following limitations on the success of these banks should not be lost sight of :—

(1) They cannot take over all the debts of the cultivators on account of the various restrictions, mentioned above, that they have to impose on the grant of loans.

(2) They can only diminish the burden of debts by taking them over and reducing the rate of interest. They cannot remove the burden.

(3) The transfer of debts to the banks will not benefit the debtors much, unless they develop business sense, learn to avoid unproductive debts and to practise thrift and increase their productive capacity.

15. *Recommendations of the Committee of Direction, All-India Rural Credit Survey Committee.*—This Committee has expressed the opinion in its report published in 1954, that the co-operative movement in India has failed so far, but should not be allowed to fail in future. The failure is shown by the following percentages of the contributions made by the main agencies of rural credit to the total borrowings of the cultivators.

Credit agency	Percentage of total borrowings.
Government	3.3
Co-operatives	3.1
Commercial banks	0.9
Relatives	14.2
Landlords	1.5
Agriculturist money-lenders	24.9
Professional money-lenders	44.8
Traders and commission agents	5.5
Others	1.8
Total	100.0

For making the co-operative movement successful in future, the Committee has made the following recommendations :—

I. The Integrated Scheme of Rural Credit

(1) One of the prior objectives of policy has to be the creation of conditions in which co-operative and other institutions will

1 See the Statutory Report of the Reserve Bank on Agricultural Credit pp. 2 4-8.

function effectively in the interests of rural production and for the benefit of the rural producer, and not as hitherto be largely stultified by the operation of more powerful private interests; for this, the necessary assistance, in the form of finance, technical personnel, etc., and not merely advice, supervision and administration, has to come from the State; hence State partnership in some of the more strategic institutions, co-operative and other, existing or new, is recommended as an important feature of the organization that should take place. Institutional development, with the object mentioned and on the basis of State partnership, should extend to (i) co-operative credit, (ii) co-operative economic activity, especially processing and marketing, (iii) storage and warehousing, and (iv) commercial banking as represented by the important sector of State-associated banks.

(2) The State Governments should be directly responsible for fulfilling the programme of co-operative development, whether of credit or of economic activity, in their respective areas. Besides the State Governments and the Planning Commission, the main agencies of reorganization and development should be: the Reserve Bank of India; the Ministry of Food and Agriculture of the Government of India and, associated with it, the National Co-operative Development and Warehousing Board, the All-India Warehousing Corporation and the State Warehousing Companies; the State Bank of India; the Central Committee for Co-operative Training and the Co-operative Movement itself.

(3) The main Funds for the financing of reorganization and development should be :

(i) Under the Reserve Bank

(a) The National Agricultural Credit (Long-term Operations) Fund.

(b) The National Agricultural Credit (Stabilization) Fund.

(ii) Under the Ministry of Food and Agriculture

The National Agricultural Credit (Relief and Guarantee) Fund.

(iii) Under the National Co-operative Development and Warehousing Board.

(a) The National Co-operative Development Fund.

(b) The National Warehousing Development Fund.

(iv) Under the State Bank of India
The Integration and Development Fund.
(v) Under each State Government
(a) The State Government Credit (Relief and Guarantee) Fund.
(b) The State Co-operative Development Fund.
(vi) Under each State Co-operative Bank, Central Co-operative Bank, etc.
The Agricultural Credit Stabilization Fund.

II. THE RESERVE BANK

(4) The Reserve Bank should contribute (i) not less than Rs. 5 crores per annum to the National Agricultural Credit (Long-term Operations) Fund, and (ii) not less than Rs. 1 crore per annum to the National Agricultural Credit (Stabilization) Fund; the position in regard to these contributions should be reviewed at the end of 5 years. In addition, there should be an initial non-recurring contribution of Rs. 5 crores to the National Agricultural Credit (Long-term Operations) Fund.

(5) Out of the National Agricultural Credit (Long-term Operations) Fund, the Reserve Bank should be enabled to make long-term loans to State Governments for the purpose of their subscribing, directly or indirectly, to the share capital of co-operative credit institutions.

(6) The Reserve Bank should continue to make short-term accommodation available through state co-operative banks. As at present, such accommodation should be usually given on the guarantee of the State Governments. The Reserve Bank should also give medium-term loans (of periods of 15 months to 5 years) to state co-operative banks and, through them, to central co-operative banks or societies. The medium-term loans should be given out of the National Agricultural Credit (Long-term Operations) Fund.

(7) The Reserve Bank should give long-term accommodation to land mortgage banks (a) by way of direct loans and (b) by purchase of the whole or part of their 'special development debentures' by drawing upon the National Agricultural Credit (Long-term Operations) Fund.

(8) When the Reserve Bank is satisfied that short-term loans of which repayment to it has become due by state co-operative

banks cannot be repaid in due time without serious dislocation to the co-operative credit structure of the State, on account of famine, drought, etc., the short-term loans should be technically treated as repaid to the Reserve Bank's Banking Department, but in effect converted into medium-term loans from the Reserve Bank's National Agricultural Credit (Stabilization) Fund. The Reserve Bank may make this facility conditional on the state co-operative bank concerned maintaining a similar Agricultural Credit Stabilization Fund, the same applying to central banks and, where feasible, the larger-sized primary societies.

III. The State Bank of India

(9) An 'Integration and Development Fund' should be instituted within the State Bank of India. To this Fund should be diverted the dividends earned by Government and the Reserve Bank on their shares in the institution. An initial contribution of Rs. 50 lakhs in all should be made to the Fund by Government and the Reserve Bank as also subsequent ad hoc contributions as and when necessary. The main purpose of the Fund would be to meet, when necessity arises, the net additional cost to the State Bank involved in opening, in pursuance of State policy, such branches as may initially be unremunerative.

IV. The National Co-operative Development and Warehousing Board and its Auxiliaries

(10) The National Co-operative Development and Warehousing Board should be constituted by statute with the Minister for Food and Agriculture as Chairman, the Secretary of the Ministry of Food and Agriculture as Vice-Chairman and twelve other members, *viz.*, a representative each of the Planning Commission, the Finance Ministry (Department of Economic Affairs), the Railway Board, the Reserve Bank and the State Bank of India; the Consulting Engineer (Road Development) to the Government of India, Ministry of Transport; the Chairman, Forward Markets Commission; one economist; two co-operators; and two other non-officials.

(11) The more important functions and objects of the National Co-operative Development and Warehousing Board should be to promote the planned development, throughout the country

of the co-operative processing and marketing of agricultural commodities and of facilities for the storage and warehousing of such commodities; to promote the planned development, throughout the country, of agricultural production on a co-operative basis; and to promote, on a countrywide scale, the distribution to the cultivator, as far as possible on a co-operative basis, of his basic requirements as producer and consumer.

(12) In pursuance of the above objects, it should give financial aid and accommodation as well as other forms of assistance to State Governments and through them to co-operative organizations; give general directions to the All-India Warehousing Corporation and to attach conditions to any loan or subsidy or other assistance given to the All-India Warehousing Corporation and State Warehoushing Companies for building godowns and warehouses; and administer the National Co-operative Development Fund and the National Warehousing Development Fund.

(13) The Government of India should make an initial non-recurring contribution of Rs. 5 crores to the National Warehousing Development Fund. It should also make a recurring contribution of not less than Rs. 5 crores every year for the two Funds together. Other sources for the Funds will be ad hoc grants from the Government of India and foreign assistance.

(14) The National Co-operative Development Fund may be utilized for giving long-term loans or subsidies to State Governments to enable them to subscribe to the share capital of co-operative societies when undertaking activities (especially processing and marketing), falling within the purview of the objects of the Fund.

(15) The National Warehousing Development Fund may be utilized for subscribing to the share capital of the All-India Warehousing Corporation; making loans to a State Government to enable it to subscribe to the share capital of the State Warehousing Company pertaining to its State; and giving loans or subsidies to the All-India Warehousing Corporation and (through it or otherwise) to a State Warehousing Company.

(16) The All-India Warehousing Corporation should have an authorized share capital of Rs. 20 crores. The issued and paid-up share capital should be Rs. 10 crores. 40 per cent. of the paid-up share capital should be subscribed by the National

Co-operative Development and Warehousing Board, 10 per cent. by the State Bank of India, 15 per cent. by other commercial banks, 20 per cent. by insurance companies, investment trusts etc., 10 per cent. byjoint-stock companies dealing in agricultural commodities and 5 per cent. by organized forward markets such as the East India Cotton Association. A minimum dividend should be guaranteed on the share capital of the Corporation by the Government of India. Debentures issued by the Corporation should be guaranteed by the Government of India as to both principal and interest.

(17) The Board of the All-India Warehousing Corporation should consist of 7 representatives of the National Co-operative Development and Warehousing Board and 4 more consisting of one representative each of (i) the other commercial banks, (ii) insurance companies, (iii) joint-stock companies and forward markets, and (iv) a Managing Director.

(18) The more important functions of the All-India Warehousing Corporation, subject to the general directions of the National Co-operative Development and Warehousing Board, should be to acquire and build godowns and warehouses at places of All-India importance; to run licensed warehouses and train the necessary cadres and staff for this purpose; to manage regulated markets; and to subscribe to the share capital of State Warehousing Companies.

(19) The authorized share capital of a State Warehousing Company should normally be Rs. 2 crores and the issued and paid-up share capital, Rs. 50 lakhs. Not less than 50 per cent. of the share capital of a State Warehousing Company should be subscribed by the All-India Warehousing Corporation on condition that the rest is subscribed by the State Government.

(20) The Board of a State Warehousing Company should consist of eleven members including the Chairman and the Managing Director.

(21) The main functions of a State Warehousing Company should be the acquiring and building of godowns at places other than those earmarked for the All-India Warehousing Corporation; running of licensed warehouses; doing 'distribution' work; and subscribing to the share capital of co-operative societies concerned with storage or warehousing as their primary function or as one of their primary functions.

(22) While a State Warehousing Company should ordinarily aim at having its own godowns and warehouses up to the district and sub-divisional levels, co-operative warehouses should be established in the smaller towns and the taluka headquarters and at other important marketing centres in the semi-urban and rural areas. This programme should then be linked to the bigger villages by encouraging co-operatives in such villages to build godowns, seed-stores, etc., in exercise of their multi-purpose functions.

V. The Co-operative Agency

(23) The basis of reorganization of the relevant parts of the co-operative structure should be State partnership. At the apex level, the State Government should directly contribute to the share capital of the institutions concerned. At the district and primary level, the State partnership should be through the apex institutions. In certain cases, *e.g.*, marketing and processing societies, State partnership may be direct at all levels.

(24) Each State Government should, as early as possible, draw up, in consultation with the Reserve Bank (or, as the case may be, the National Co-operative Development and Warehousing Board), a phased programme for the reorganization, on the basis of State partnership, of its co-operative institutions—short-term credit, long-term credit, marketing, processing, milk supply, dairying, etc., at all levels. At the apex and central levels invariably (and at the primary level generally) not less than 51 per cent. of the share capital of these institutions should be held by, or derived from, the State Government. In the case of a larger-sized primary agricultural credit society and all other societies at the primary level, the objective should be to retire the whole of the State-derived contribution within a period of time to be fixed after taking into account the relevant circumstances so that, at the end of that period, the societies at the primary level would become fully co-operative.

(25) The subsistence needs of the agricultural producer—as distinguished from specific 'consumption' needs connected with marriages, funerals, etc.—should be treated as needs which ought to be legitimately fulfilled by the co-operative credit system.

(26) The credit arrangements for the village handicraftsman should eventually be part of the normal co-operative credit

system; Government should, where needed, provide adequate guarantees to the system to enable it to undertake this work.

(27) Credit arrangements for specific consumption needs connected with marriages, funerals, etc., should be made through a chit fund affiliated to the large-sized primary agricultural credit society. This arrangement should cover others besides the ordinary members of the society itself.

(28) While the state co-operative bank and central land mortgage bank should continue to remain separate entities legally and financially, direction and management should be common to the farthest extent possible and the same administrative staff should operate under the two types of institutions.

(29) Complementary to the establishment of a National Agricultural Credit (Stabilization) Fund in the Reserve Bank is the need to institute individual Agricultural Credit Stabilization Funds of their own by state co-operative banks, central co-operative banks, and, wherever feasible, also by the larger-sized primary agricultural credit societies. The dividend in excess of a prescribed level paid on shares held by Government (directly or indirectly) should, in part, be credited to this Fund. Dividends in excess of a slightly higher level, in the case of those payable to other shareholders, should also be credited to the Fund.

(30) The membership of state co-operative banks should be open to all central banks and such other co-operative credit institutions as have direct dealings with it. A strictly limited number of individuals may be allowed to become members.

(31) Ordinarily, Government should not be allotted more than a third of the seats on the directorate of the above banks for nomination of its representatives. At the same time, Government should, on certain specified matters, have overriding powers.

(32) In addition to accretion to share capital through State partnership, two methods of increasing share capital suggested for adoption are: (a) to insist on the contribution by member central banks and societies of an amount equal to a prescribed proportion of their own share capital; and (b) to relate the borrowing of members to their shareholding.

(33) In the loan operations of state co-operative banks, the demands for agricultural credit should receive the first priority.

Loans to individuals should be given only to a very limited extent, *e.g.*, against their fixed deposits with the bank.

(34) The apex bank should be made the custodian of the surplus resources of the co-operative banking system and for this purpose all co-operative central financing agencies should be statutorily required to invest their surplus funds in the apex bank.

(35) Each State should have a central land mortgage bank.

(36) The size of Government contribution to share capital, while subject to a minimum of 51 per cent. should be such as to help establish, irrespective of the proportion of private capital forthcoming, an adequate number of central land mortgage banks whose financial structure enables them to borrow adequately and lend adequately.

(37) Land mortgage banks should give first priority to applications for loans for improvement, reclamation and development of land, purchase of agricultural machinery and equipment and other productive purposes.

(38) Ordinarily, there should be only one central co-operative bank for each district.

(39) State partnership (through the state co-operative banks) in the share capital of central co-operative banks of not less than 51 per cent. should not imply the nomination of more than a third of the directors by the state co-operative bank, but, as in the case of state co-operative banks, Government should have special powers. The local agent of the State Bank of India should invariably be nominated as one of the members of the board of the particular central co-operative bank.

(40) The first priority in loan operations of the central banks should be given to the requirements of agricultural credit societies ; loans to individuals should be rigidly restricted, *e.g.*, to advances against their fixed deposits.

(41) The central banks should build up close and continuous contacts with the primary agricultural credit societies, be sympathetic and responsive to their needs and endeavour to assist them to the best of their capacity.

(42) Programmes of establishing branches of the central banks at sub-divisional centres and other suitable places should be pursued in conjunction with similar programmes for branch extension of the State Bank of India.

(43) Primary agricultural credit societies should hereafter be established, or wherever necessary existing ones reorganized, so as to cover, according to local conditions, groups of villages with a reasonably large membership and reasonably adequate share capital.

(44) There should be a concerted drive to organize larger-sized societies in selected areas such as those in which Community Projects or National Extension Service Blocks have been in operation or are about to be established.

(45) The larger-sized primary agricultural credit society should be established on the basis of limited liability.

(46) The Central co-operative bank should initially contribute to the society whatever amount is necessary for ensuring that the total share capital is not below the minimum level. For this purpose, the State Government should make the needed finance available to the state co-operative bank (*e.g.*, in the shape of additional share capital) to enable it to provide funds to the central co-operative bank. Until the optimum level of share capital is reached, there should be compulsory contributions from members together with a proportionate (indirect) contribution by Government. After the optimum level is reached, the Government-derived contribution should cease, but compulsory contributions from members should continue for retiring the whole of the Government-derived contribution within a suitable period.

(47) As a rule, only fixed deposits should be accepted by primary agricultural credit societies and current deposits confined to the apex and central banks and their branches.

(48) Agricultural credit societies in general should be encouraged to deposit their funds with central banks.

(49) There should be annual allocations to reserves out of profits.

(50) The maximum borrowing limit of the larger-sized primary agricultural credit societies should be fixed at a certain multiple of their paid-up share capital and reserves.

(51) In regard to loan operations, the emphasis should be on crop loans. For the success of the crop loan system, two important prerequisites are adequate supervision and efficient arrangements for recovery of loans.

(52) Besides crop loans, primary agricultural credit societies may provide medium-term loans (*i.e.* for periods longer than 15 months but not exceeding 5 years) for productive purposes; the total of such loans should be limited to paid-up capital and reserves together with the medium-term funds obtained from the central financing agencies.

Agricultural credit societies may also supply members' requirements for crop production and also basic, but standardized, consumers' goods on the basis of indents or of established demand.

The primary society should finance its members on condition that their produce is sold through the marketing society with which it works in co-ordination.

The various State Governments should establish State Agricultural Credit (Relief and Guarantee) Funds which should be used in conjunction with the Government of India's National Agricultural Credit (Relief and Guarantee) Fund. Where irrecoverable arrears of debts due to co-operative credit institutions have assumed a magnitude which threatens the stability of the structure and provided the Ministry of Food and Agriculture is satisfied that such arrears have arisen from causes, such as widespread or chronic famine, beyond the control of the co-operative institutions concerned, the Funds of the Central and State Government should be utilized for the purpose of writing off such arrears.

Payments which may be necessitated as a result of certain categories of Government guarantee should be legitimately payable out of the State Agricultural Credit (Relief and Guarantee) Fund.

Two types of contribution to the State Agricultural Credit (Relief and Guarantee) Fund should be (a) annual budgetary provision by the State Government, and (b) part of the dividend earned by the State Government on its share capital in the various co-operative credit agencies to the extent that such dividend exceeds a particular minimum.

16. *Implementation of the Recommendations of the Rural Credit Survey Committee.*—The enactment of the State Bank of India Act, under which the Imperial Bank of India was transformed into the State Bank of India, was the most important step taken in 1955 in pursuance of the recommendations of the above Committee. Next, to enable the Reserve Bank to play

an active part in the organization of the co-operative structure and to facilitate the supply of rural credit, the Reserve Bank Act was amended in 1955 so as to provide for the setting up of the National Agricultural Credit (Long-Term Operations) Fund and the National Agricultural Credit (Stabilization) Fund. As on 30th June 1961, the amounts to the credit of the above two funds were Rs. 50 and 6 crores respectively. By June 1961, the Reserve Bank had sanctioned loans to the extent of Rs. 40 crores out of the former Fund to 12 State Governments to enable them to contribute to the share capital of co-operative credit institutions within their respective jurisdictions. The latter fund has not been drawn upon so far.

As a part of the Second and Third Five Year Plans, schemes for co-operative development in the States were formulated on the basic principles governing the Integrated Scheme outlined by the above Committee. Further, as recommended by the Committee, the Agricultural Produce (Development and Warehousing) Corporations Act was passed in 1956 and under it the National Co-operative Development and Warehousing Board and the Central Warehousing Corporation were established by the Central Government. The Board gives loans and subsidies for co-operative development plans, such as contributions to the share capital of marketing and processing societies and construction of godowns. The Corporation established 40 warehouses at different places in the country upto the end of June 1961 and State Warehousing Corporations had established 267 warehouses, The Reserve Bank drew the attention of commercial and co-operative banks at these places to the facilities available at these warehouses for storage of commodities and exempted the advances granted by scheduled banks on the pledge of receipts issued by these warehouses for commodities stored in them, from its directive for restricting the advances of scheduled banks against foodgrains.

17. *Conclusions and Recommendations of the Committee on Co-operative Credit.*—The following are the more important conclusions and recommendations of the Committee on Co-operative Credit appointed by the Government of India in 1960 :—

Along with the implementation of the schemes of agricultural improvement under the Third Five Year Plan, the farmers will require more medium-term and long-term credit. But, the average working capital of primary agricultural credit societies is only Rs. 8,031. Nearly one-third of the societies are working

in loss or are not making any profit. Of the 1.35 lakh societies, only about 22,000 are in A and B categories, about 81,000 in C and about 22,000 in D and E, about 10,000 being unclassified. A large number of C class societies, which are dormant and weak, require considerable reorganization and revitalization. Some of them may even have to be liquidated, if attempts to revive them fail. Out of 418 central co-operative banks and banking unions, 44 per cent. do not come up to the minimum standards regarding owned funds and working capital. They should build up their resources quickly and expand their loan business.

Special staff should be appointed in all the States to attend to the rectification of dormant and weak societies. A main aim of future endeavour must be to make all societies viable units, *i.e.* units capable of rendering the more important of the services expected of credit societies, both adequately and to a large majority of farmers, without depending upon financial assistance from Government, except for a limited period, and also capable of meeting its expenditure on adequate and competent staff and providing for reserves and a reasonable return on capital. The co-operative aspect is as important as that of viability. Hence, no village, included in a society, should be at a distance of more than four miles from the headquarters village and the coverage should not exceed 3,000 persons or 500 cultivating families.

The contribution from a State Government to the share capital of a viable society should range from Rs. 1,000 to Rs. 10,000 on a matching basis. Further the society should undertake to collect additional share capital of not less than Rs. 3,000 from its members over a period of five years. Government should be a partner in the real sense and participate in the risk of business in the same manner as any other shareholder, so that its contribution will also serve as a margin of security to the creditors. Moreover, a State Government may give it a subsidy of Rs. 1,200 for a period not exceeding five years.

The society should provide funds for agricultural production even to those cultivating members, who do not own landed property, but who are protected from arbitrary eviction and are ensured a good share of the crops raised by them, by the various land reform measures carried out in the different States, provided that they are creditworthy, *i.e.* honest and possessing the necessary repaying capacity and produce sureties who also need not be owners

of land. To minimise the scope for misapplication, the loans should be given in kind *i.e.* seeds, fertilisers, agricultural implements, etc., as far as possible. To promote a sense of responsibility and loyalty and to promote thrift, individual members, should be required to contribute to the society's capital at least to the extent of 10 per cent. of their borrowings from it.

Primary agricultural societies need a strong capital base because (1) if they are multipurpose societies, they may engage in non-credit activities also and may need large resources, (2) mobilization of resources through deposits is a slow process, (3) such a base will not only reduce their reliance for funds on outside agencies, but will also inspire greater confidence among their creditors and (4) they can absorb the shock of overdues.

Therefore the societies should do their best to augment their share capital even beyond the level of 10 per cent. of the borrowings recommended above.

There should be a ceiling on loans to individual members and a ceiling on additional loans against pledge of ornaments or goods or fixed deposit receipts. Members should be allowed short-term loans on the production of two sureties from fellow members, whether or not they own land. Mortgage security need not be insisted on even for medium-term loans upto Rs. 500. Where benefits of improvement take time to accrue, repayment, in instalments, of a medium-term loan may be allowed to commence from the end of the second or third year.

At the village level, there should be only one institutional agency for the supply of credit, *viz.* the co-operative credit society. Hence, disbursement of taccavi loans and loans granted in block areas under the Community Development Programme, for purposes such as sinking of wells, land improvement etc. should be channelled by Government through the village co-operative credit society, wherever it exists.

Organization of viable co-operative credit societies would generally be more suitable on the basis of limited liability. It is not necessary to enhance, as a rule, the present credit limits of eight times the owned funds of limited liability societies and of one-eighth of the net assets of members of unlimited liability societies.

It is not necessary, as a rule, to revise the existing credit limits of Central and State co-operative banks, which are generally ten to twelve times the owned funds for Central co-operative banks

and fifteen times the owned funds for State co-operative banks. In special cases, the Registrar may extend the limits upto fifteen and twenty times for Central and State banks respectively.

Primary credit societies should be required to contribute to the share capital of a central co-operative bank at the rate of one-twentieth of their borrowings from it, so that the latter's owned capital will increase automatically and proportionately with the increase in its loan operations.

State and Central co-operative banks should make special efforts for tapping deposits from urban areas by offering competitive rates of interest on deposits, in the face of competition for available funds from commercial banks and Government, by providing reasonable banking facilities to individuals such as opening current accounts, collecting cheques and bills, issuing demand drafts, etc., and by opening branches in suitable centres. Government should make substantial contributions to their share capital in order to impart to them the financial strength necessary to inspire confidence among the depositors. The rate of interest charged ultimately to the cultivator should depend upon the prevailing money rates and the need of the co-operatives to attract larger funds by way of deposits.

As a rapid agricultural development is envisaged in India and as the co-operatives have been chosen as the best agency for the provision of credit, it would be unrealistic to expect them in the near future to raise the necessary resources, wholly or even in bulk, from owned funds and deposits. Achievement of self-help and self-reliance, which are undoubtedly the guiding principles of co-operation, is a relatively slow process. The Reserve Bank, therefore, will have to continue to play a prominent part in providing funds to co-operatives for many years to come. The Reserve Bank's policy in this respect is a part of the national policy of building up a strong, sound and country-wide structure of co-operative credit for agriculture and other purposes. The Bank, therefore, in the context of providing short and medium-term credit to co-operatives on a more liberal scale than at present, should take into account the efforts made by the co-operative movement in (i) increasing its financial strength and operational efficiency, (ii) developing its resources through share capital and deposits with a view to promoting greater self-sufficiency, and (iii) extending the provision of agricultural credit.

The Reserve Bank should grant short-term accommodation for agricultural purposes to central co-operative banks through State co-operative banks upto 4 and 3 times their owned funds to A and B class central banks respectively as a normal feature and, in addition, as a special case, 2 and 1 times the owned funds of A and B class central banks, subject to certain conditions and safeguards. The Reserve Bank may grant short-term accommodation to C class central banks upto 3 times their owned funds against Government guarantee for 3 years, during which a systematic programme of rectifying their defects and consolidating them, should be completed.

To enable the Reserve Bank to liberalise its present standard for giving medium-term loans to central banks, namely equal to their own funds, the Reserve Bank should be authorised by the Government of India to credit Rs. 15 crores annually, instead of the present Rs. 5 crores, to the Long-Term Operation Fund, out of which such loans are granted. The provision of more such loans should be co-related to the efforts made by a central bank in raising more medium-term funds in the form of share capital and fixed deposits.

The Government of India should take up with the U.S.A. authorities the question of allocating a part of P.L. 480 Funds to the co-operative credit structure for the provision of medium-term and long-term finance for promoting agricultural development.

To enable them to tide over financial difficulties arising from widespread adverse seasonal conditions of agriculture and the consequent failure on the part of the borrowers to repay their loans, primary societies, central banks and State banks must be made to constitute an Agricultural Credit Stabilization Fund and to go on strengthening it, as the Reserve Bank is doing for helping the co-operative financing agencies. Similarly, State Governments should set up a Relief and Guarantee Fund.

If primary societies and financing banks are enabled by suitable assistance in the forms of Government guarantees for losses sustained by them and Government contributions, to withstand accumulation of overdues and ultimate losses arising out of such overdues, they will be able to go ahead with the programme of financing in earnest all classes of cultivators, including marginal or sub-marginal cultivators, who possess repaying capacity, but no land. Government may make outright contributions to the

funds of each society and each financing bank to the extent of 3 and 1 per cent. respectively of the additional loans given by it during a year over and above those given by it in the preceding year. The role of the Government, however, should not extend to the internal management of societies and banks, which should be left to the representatives of the members themselves.

18. *Debt conciliation and liquidation.*—Land mortgage banks can be used for debt redemption only by those who have sufficient landed security to offer, and who have a sufficient surplus income, after meeting their expenses of cultivation, subsistence, and other current needs, to pay the annual instalments of debt redemption for a long period. A substantial proportion of agriculturists cannot fulfil these conditions, and have, therefore, been unable to use land mortgage banks for the redemption of their debts. The danger of progressive and serious deterioration in their economic position, and of the growth of discontent among them, has been so great that it has been necessary for State Governments to initiate and develop a vigorous policy of effecting conciliation between debtors and creditors, and securing a composition of the debts on a voluntary basis. Many creditors, on account of the difficulties of recovery, would agree to substantial reductions in their claims, if they could be sure of receiving the amounts settled during a certain period, without any further trouble to them. Attempts at debt conciliation were first made in parts of the Central Provinces, the Punjab and Bihar on a moderate scale and with some success.[1] This experience showed that for the success of any scheme of debt conciliation, an organization must be created, and that Government and co-operative credit societies must come forward to help the debtors. The Central Banking Committee, therefore, made the following recommendations :—

(1) In each province special officers should be appointed to induce creditors and debtors to agree to a redemption of debts in the form of equated payments spread over a period of years, or of immediate cash payment in part and equated payments for the rest.

(2) The officers should explain to the debtors the facilities provided by the Usurious Loans Act and the Civil Procedure

[1] For accounts of these attempts see the Punjab and C.P. Committees Reports, pp. 173-4 and 148 respectively.

Code for easing the burden of debt; and conciliation boards should be appointed by Government, if necessary, to help them.

(3) The cash and equated payments should be made to the creditors by the debtors through co-operative societies, which the latter should join, so that the societies could meet their short-term and intermediate financial needs in future.

(4) To enable immediate cash payments to be made to the extent insisted upon by the creditors, Government should give advances to the societies, which would gradually repay them as the societies were repaid by the debtors.

(5) The portions of the settled amounts not paid to the creditors immediately in cash should be regarded as deposits by the creditors with the societies, to be repaid to them *pari passu* with the annual instalments fixed for the debtors.

(6) The annual instalments to be paid by the debtors should be fixed on the basis of their paying capacity, after making a sufficient allowance for their expenses of cultivation and subsistence.

(7) Government should help the societies if they suffered loss on account of defaults of the borrowers regarding the payment of their annual instalments, unaccompanied by any negligence or mismanagement on the part of the societies.

(8) This scheme should be put into operation by means of an Act, if necessary.

Whenever the creditors did not agree to a voluntary settlement of debts, they would have to be compelled to accept a settlement, and the Central Committee recommended legislation for this purpose. It also supported the recommendation of the Agricultural Commission and the Civil Justice Committee that the case for passing a simple Rural Insolvency Act should be considered in every province, as agricultural debtors found it most difficult to use the complex mechanism of the prevailing Insolvency Act, which had been passed principally for the benefit of the mercantile classes. On the other hand, for the just protection of the creditors, civil courts should be required to deal more expeditiously with insolvency petitions, and should make official receivers and assignees take all possible steps to realize assets and wind up bankruptcies with minimum delay, so as to minimise the scope for debtors to secrete or alienate their property. Moreover, the officials should scrutinize the

records of bankrupts, to ensure that the liquidation had not resulted from any culpable action on their part, and should order prosecution, if necessary.[1]

So far the Governments and Legislatures of the Central Provinces, the Punjab, Bengal, Madras and Assam have given effect to these recommendations partially by passing Debt Conciliation Acts. These Acts empower the Provincial Governments concerned to set up a Debt Conciliation and Settlement Board in each district or a local area for relieving agriculturists from indebtedness by amicable settlements between them and their creditors. A debtor or any of his creditors may apply to the Board to effect a settlement, giving particulars of the claims against the debtor or in favour of the creditor, and of the debtor's property and income. The Board then calls upon the debtor and each creditor to explain his case regarding each debt, and endeavours to induce them to arrive at an amicable settlement. If no amicable settlement can be arrived at, the Board dismisses the application. The Board can do the same, if it does not consider a settlement desirable or practicable, or if the applicant fails to pursue his application with due diligence, or if the debtor attempts to defraud any creditor. Each settlement, if arrived at, is reduced to writing in the form of an agreement and registered under the Indian Registration Act, and then takes effect as if it were a decree of a civil court. If a debtor defaults in paying any amount according to the agreement, such amount is recoverable as an arrears of a public demand or land revenue on the application of the creditor. Where the District Head finds it irrecoverable in this way, it is recoverable as if a decree of a civil court had been passed for its payment. When any creditor refuses to agree to an amicable settlement, the Board may grant the debtor a certificate to this effect, and if the creditor sues the debtor in a civil court after the latter has been given such a certificate, the court cannot allow the creditor any costs in the suit or any interest on the debt after the date of the certificate in excess of 6 per cent. per annum. Any decree passed by a civil court in a suit for the recovery of any other debt cannot be executed until after the expiry of the period fixed in the above agreement.

1 *Cf.* Madras Committee Report, p. 178.

Debt Conciliation Boards have not obtained substantial success. Their number has been small, and their working has involved friction and delay. Moreover, making arrangements for the repayment of the settled debts has always proved to be a difficult problem. Generally instalments spread over 15 to 20 years have to be arranged. Creditors would agree to larger remissions and the work of the Board would be more successful, if land mortgage banks can be prevailed upon to advance the entire settled amount to the creditors, and then to recover it in suitable instalments from the debtors.

Later, for affording relief to the indebted agriculturists who were hit hard by the economic depression, some of the Provincial Governments preferred compulsory scaling down of the debts to scaling them down voluntarily by the method of conciliation, because the latter depends upon the goodwill of the creditors and, therefore, often involves uncertainty, friction and delay. The Madras Congress Ministry was the first to enforce the principle of compulsion by getting the Madras Legislature to pass the Madras Agriculturists' Relief Act in 1938, which distinguishes between debts incurred before the depression and those contracted during it. It provides that debts incurred before 1st October 1932 shall be scaled down as follows :—

(1) All interest outstanding on 1st October 1937 shall be deemed to be discharged, and only the principal outstanding shall be deemed to be the amount repayable by the agrcultiurist on the date.

(2) Where an agriculturist has paid twice the amount of the principal, the debt shall be deemed to be wholly discharged.

(3) Where the sums repaid fall short of twice the amount of the principal, such amount only as would make up this shortage or such portion of the principal as is outstanding, whichever is smaller, shall be repayable.

As regards debts incurred after 1st October 1932, it provides that they shall be scaled down by calculating interest at 5 per cent. simple interest up to 1st April 1938. Further, it lays down that all debts scaled down and remaining unpaid as well as new loans shall be charged interest at not more than 6¼ per cent. simple interest, but that the Provincial Government may fix any other rate from time to time. The Act exempts co-operative societies and certain classes of banks from its operation. The

Act gives relief to tenants also by cancelling all rent arrears except those of the previous two years, provided the latter are paid before September 1939. Finally, the Act provides for cancellation of sales of movable or immovable property of the agriculturists, if such sales have been effected in execution of decrees after 1st October 1937. The enforcement of the Act has been left to the ordinary courts.

One drawback of this Act is that it has not provided any machinery for paying the creditors on behalf of the debtors, the debts scaled down by the courts and recovering the amounts in easy instalments from the debtors. Although there are many land mortgage banks in the Madras State, creditors are not made by the Act to receive payments through them. Another drawback is the maximum rate of interest laid down by the Act (6¼ per cent.) is too low. It should be revised by Government, as it restricts unduly the supply of credit available to the agriculturists. On the other hand, it is stated that unscrupulous money-lenders have been evading this legal restriction in collusion with needy borrowers.

The Bombay Agricultural Debtors' Relief Act of 1939 empowers the Government of Bombay to establish a Debt Adjustment Board for any local area. The awards of such a Board are subject to appeal to the District Court if the total amount payable under the awards exceeds Rs. 5,000, and to the court of the First Class Sub-Judge if the amount does not exceed Rs. 5,000, and the court's decision is final. Within 18 months from the establishment of a Board, a debtor or his creditor may make an application to the Board for the adjustment of the formers' debts, making a full and correct statement of the debts. The Act lays down that every debt, in respect of which no application for adjustment is made within 18 months of the establishment of the Board, shall become void, unless the Board is satisfied that for good reasons the creditor had no opportunity of making an application. If any debtor and his creditors arrive at a settlement in respect of any debt, an application for recording it must be made within a month to the Board, which will record and certify it, if it is in the interests of the debtor and is not intended to defeat or delay the creditors. The Board must then make an award in terms of the settlement. If all the debts due by a debtor are unsecured, such debts as are found due must be scaled down by the Board pro rata to the

value of the paying capacity of the debtor, calculated by taking the difference between the secured debts and 80 per cent. of the value of the immovable property on which such debts are secured, plus 80 per cent. of the value of the immovable property which is not subject to the liability of the secured debts, plus 80 per cent. of the value of the other assets of the debtor. If all the debts are secured debts and are more than 80 per cent. of the value of the property of the debtor, they must be scaled down by the Board pro rata to 80 per cent of the value of the property. If the debts are both secured and unsecured, and if the total amount of the secured debts is more than 80 per cent. of the value of the property on which such debts are secured, the secured debts must be scaled down pro rata to 80 per cent. of the value of the property on which such debts are secured, and the unsecured debts must be scaled down to 80 per cent. of the value of the remaining property belonging to the debtor.

Further, the Act lays down that the Board must lay down the instalments in which each debt must be paid, and that the annual instalment must not exceed the debtor's annual paying capacity, ascertained by deducting from his annual income the amount necessary for the maintenance of himself and his dependents and the amount he has to pay to Government, local authorities and resource societies. Interest is allowed at not more than 6 per cent. on debts contracted up to the end of 1938, and at not more than 9 per cent. on those contracted later. If the creditors agree to have the debts scaled down to half of the value of the immovable property of the debtor and to accept, in lieu of the debts, bonds issued by the Bombay Provincial Co-operative Land Mortgage Bank and guaranteed by the Government of Bombay, and if the Bank agrees to this arrangement, the Board must make such an award, and all the sums due under the award made in favour of the Bank are recoverable as arrears of land revenue. The Board must transmit each award to the court, which must register it, if no appeal is received or the appeal is dismissed, and the registered award is executable as a decree of the court. Finally, if the Board is satisfied that the paying capacity of the debtor is inadequate to pay his debts as scaled down, the Board can declare him to be an insolvent. Thus, the Bombay Act is free from the drawbacks of the Madras Act.

The Central Provinces Relief of Indebtedness Act of 1939 provides for the creation of Debt Relief Courts with appeals

to the District Courts, in place of the Debt Conciliation Boards provided by the Act of 1933. It provides 30 per cent. reduction in debts contracted up to the end of 1925, 20 per cent. reduction in those contracted from the beginning of 1926 up to the end of 1929, 15 per cent. in those incurred during 1930, and no reduction in those incurred from 1931. It limits the interest to 6 and 9 per cent. on secured and unsecured loans respectively. The U.P. Agriculturist Debt Redemption Act (1939) authorizes the courts of law to award a creditor a sum not exceeding twice the amount of the principal less all the amounts received by him previously in respect of that transaction. Its chief aim is to reduce effectively the debts of cultivators.

The Committee of Direction, Rural Credit Survey, has stated that broadly in Part A States debt adjustment has involved reductions ranging from 40 to 60 per cent. and in Part B States from 20 to 40 per cent. but that debt relief has involved shrinkage in credit.

CHAPTER IV

RURAL FINANCE: COMMERCIAL BANKS, LOAN OFFICES, NIDHIS, CHIT FUNDS AND GOVERNMENT TAGAVI LOANS

1. *Commercial banks.*—The commercial banks and the State Bank of India do not finance agriculturists directly to any appreciable extent, because they are not organized to deal with them. They cannot keep themselves in close touch with the doings of agriculturists; and the uneconomic nature of the majority of agricultural holdings, and the slenderness and non-liquidity of the security that agriculturists can offer, also prevent them from regarding agricultural finance as a part of their general business. A few banks, however, especially the smaller ones, lend direct to landlords and the more substantial cultivators to some extent on the pledge of produce, ornaments, or other valuables, or on mortgage at rates varying between 6 and 9 per cent. The State Bank also does the same, and also lends to them on personal security with at least two good sureties at 6 or 7 per cent. The Central Banking Committee has recommended that all these banks should lend liberally to agriculturists

on the security of precious metals, including ornaments, as this will be helpful in saving them to some extent from the clutches of money-lenders.

These banks, especially the State Bank, finance agriculture indirectly to a large extent through merchants and dealers. Agriculturists, however, have often to pay high rates for such indirect finance, owing to the intervention of intermediaries. This finance takes the form of advances against produce to approved commission agents and dealers at 7 or 8 per cent.; of financing the movement of produce from the mandis (marts) to the consuming centres, largely by the purchase of demand drafts representing produce despatched by approved customers; and of financing the movement of produce from the collecting centres to the exporting ports by the purchase of drafts or telegraphic transfers drawn on the ports.

Commercial banks provide working finance to plantations, chiefly tea and coffee, against hypothecation of their standing crops. They are likely to take greater interest in providing medium-term finance to the plantations if the following facilities are provided to them. :—

(1) As the success of the agricultural operations of the plantations is dependent upon the vagaries of the monsoon and other unpredictable natural causes, a scheme of crop insurance should be introduced, as in other advanced countries, and should be worked by a special institution under the control of the Government of India.

(2) The Tea and Coffee Boards should set up panels of expert valuers and assessors, whose authentic crop reports should be made available to those banks which grant advances against hypothecation of standing crops of tea and coffee.

(3) The plantations should give their entire foreign exchange business to those banks which give them advances.

(4) The Refinance Corporation for Industry should give refinance facilities to commercial banks against the latter's medium-term loans to the plantations.

(5) The proposed Agricultural Development Finance Corporation should be established soon. It will give not only long-term loans to plantations for rehabilitation, reclamation and replanting, but also enter into participation arrangements with commercial banks in making medium-term advances to the plantations.

2. *Loan offices.*—Loan offices in Bengal, and Nidhis and Chit Funds in South India occupy an intermediate position between indigenous bankers and modern joint-stock banks. Whereas in the other provinces banking development began in the sixties and seventies of the last century in the form of joint-stock commercial banking, in Bengal it took the form of land mortgage banking. The first loan office was established in 1865. The loan offices are registered under the Indian Companies Act, are owned and managed by Bengalis, and play an important part in the rural life of Bengal. Their paid-up capital is generally small, and barely a score of them have a paid-up capital of Rs. 1 lakh or more. The reserve funds of those established in recent year. are very small indeed. They have not issued any debentures, and depend almost entirely on deposits, largely from the middle class population. Interest paid on deposits varies from 4 per cent. on short-term deposits to 8 per cent. on 7 years' deposits, but usually the maximum period of deposits is 5 years.

Some new loan offices, owing to keen competition with each other and co-operative institutions, use touts to attract deposits, and pay high rates, up to 15 per cent., on them. Their main business is to lend money to land owners and cultivators against mortgage of land, pledge of ornaments, or personal security, often for unproductive purposes. They seldom finance trade or industry. But some of them have trading departments for employing their funds profitably during slack periods. The older companies charge from 12 to 18 per cent. on secured loans and higher rates on unsecured ones; the newer ones charge from 12 to 56 per cent. on secured loans and up to 112 per cent. on unsecured ones. A large proportion of the loans of the latter are unsecured. In some cases, the same persons have borrowed money from three neighbouring loan offices merely on personal security.

There is much apprehension regarding their ability to withstand bad times, as there are many small offices and they have hardly any reserve funds. A number of them failed during the economic depression, as their assets became frozen. The heavy fall in land values was responsible for the sorry plight of many loan offices. Recent debt relief legislation has also affected them adversely. Their growth, therefore, must be regulated. The best way of strengthening them would be amalgamation, but they would have to amalgamate voluntarily, and cannot be compelled to do so. The Central Banking

Committee, after modifying the recommendations of the Bengal Committee to some extent, has made the following recommendations :—

(1) The larger and well-established loan offices, which are really carrying on joint-stock banking, should be subject to the provisions of the special Bank Act that the Committee has proposed for all joint-stock banks.

(2) Other loan offices should be regulated by passing a Bengal Loan Offices Act.

(3) All of them should be prohibited under this Act from combining trade with banking, and from dealing in real properties other than those which come into their possession in the course of their business.

(4) New offices established under the Act must have minimum paid-up and subscribed capitals of Rs. 25,000 and Rs. 50,000 respectively and a subscribed capital at least half of their authorized capital.

(5) The existing offices, having a smaller paid-up capital. must deposit with Government, securities of a value equal to the difference between Rs. 25,000 and their paid-up capital.

(6) They must carry to the reserve fund at last 10 per cent. of their profits, and must not pay a dividend of more than 10 per cent. unless 25 per cent. of the profits are carried to the reserve fund.

(7) The reserve fund should be invested in post office savings banks and postal cash certificates; for loan offices the maximum holding in the latter should be raised from Rs. 10,000 to Rs. 20,000; and the surplus should be invested in trust securities.

(8) They should be prohibited from making advances against their own shares.

(9) Their balance-sheets should give more detailed information.

(10) Auditors should be ineligible to audit their accounts, if they are interested in any way in the management of the offices, or in any concerns that have been financed by the offices.

(11) All loan offices should be given 5 years to comply with the provisions of the special Bank Act or the Loan Offices Act.

(12) A special officer should be appointed by the Bengal

Government to supervise and guide the loan offices sympathetically.[1]

Mr. N. R. Sarkar, a member of the Central Committee, representing the Federation of Indian Chambers of Commerce and Industry, has stated in a separate note that as many loan offices as possible should take to commercial banking, but that they would find it difficult to do so, on account of the fact that a large proportion of their funds have become more or less frozen, as they have been lent on the security of land, which is difficult to sell, especially in a period of depression. He has, therefore, suggsted that Government should take the initiative in establishing a Loan Offices Financing Corporation, as an apex institution, which would lend funds to the loan offices on the security of their assets.

The Corporation should start with a paid-up capital of Rs. 5 lakhs contributed mainly by the loan offices themselves, and partly by individual subscribers. The Corporation should issue debentures of 20 times the amount of its capital on the security of the assets of the loan offices. Government should supervise the issue of the debentures, purchase a portion of them, and supervise the working of the Corporation. Its initial capital should be increased gradually by contributions of 5 per cent. of the amounts paid to the loan offices out of the realization of the debenture issues, and further debentures may be issued later. The Corporation should also induce the loan offices to reorganize their business, and to carry out amalgamations.

Those loan offices that prefer to continue their existing business of lending on the security of land, should be made to use for the purpose long-term deposits only, or the proceeds of long-term debentures; or they should be made to join the Provincial Land Mortgage Corporation, which the Central Banking Committee has proposed. Finally loan offices too small to come under the proposed Loan Offices Act should be established on the lines of the Friendly Societies and Building Societies of England, the U.S.A., and the British Dominions. The Central Banking Committee commended these proposals of Mr. Sarkar to the consideration of the Bengal Government and Legislature, which, however, have not given effect to any of the above recommendations of the Committee or Mr. Sarkar.

1 See Central Committee Report, pp. 195-7 and Bengal Committee Report, pp. 214-20.

3. *Nidhis and Chit Funds.*—Nidhis were originally started in South India as mutual loan societies from the middle of the last century, but in the course of time they have developed into semi-banking institutions. They are registered under the Indian Companies Act. They receive deposits in the form either of deposits proper, or of withdrawable share capital paid in monthly instalments. Their functions are to promote savings, to relieve members from old debts, to deliver them from usury, and to give them loans for all purposes on good security. Loans are given even to outsiders, if the Nidhis have spare funds. The receipt of deposits is seldom a primary function, as funds are obtained mainly in the form of share capital.[1] The Nidhis usually lend at low rates, $6\frac{1}{4}$ per cent. being a common rate, but they charge high rates on overdue amounts, and these yield a large portion of their profits. According to the Madras Committee, many of them are very well managed, but the management of some is most defective.

Chit Funds are loose organizations of a small number of persons to promote savings and to lend money to members. They exist in South India, and although their exact number is not known, it must be several thousands. A number of persons agree to make periodical payments to one of themselves, who is the promoter of the Chit, and who appropriates the first collection as his remuneration. Each successive collection is given to one of the members according to different methods, the simplest being to give it to the members in rotation, the order being decided by lots.[2] While some of these funds are properly managed, many of them are mismanaged by the promoters, some of whom are unscrupulous and resort even to fraud. Some of them are hardly better than lotteries, and appeal in the main to the gambling tendencies of the members.

For the regulation of Nidhis and Chit Funds the Central Committee has made the following recommendations :—

(1) Those which have become full-fledged banks should be registered under the Bank Act that it has recommended, if they so desire.

(2) Others should be brought under a special Act to be called the 'Nidhis and Chit Funds Act'.

(3) Those which prefer registration under the Bank Act must carry out fully its provisions, which would not permit the with-

1 See Madras Committee Report, p. 33.

2 For an account of these methods, see Madras Committee Report, p. 229.

drawal of any portion of the share capital without the permission of the High Court.

As regards the Nidhis and Chit Funds to be registered under the proposed Nidhis and Chit Funds Act, the Committee has made the following recommendations :—

(1) Nidhis should be allowed to obtain withdrawable share capital, and to lend funds on the security of their share capital as at present and, if they do this, should be prohibited from obtaining deposits or loans from outsiders.

(2) They should be permitted to have share capital paid up in a number of small instalments without the initial payment of a certain percentage.

(3) The liability of their members should be limited to the amount paid or in arrears in respect of shares and should end with the withdrawal of capital.

(4) They should not be allowed to engage in trade.

(5) Their balance-sheets should be properly audited and published.

(6) Each Chit Fund should be separately registered.

(7) Promoters of Chit Funds should be licensed and should possess some property qualification.[1]

Such control may put an end to some of the Chit Funds, but this is no reason for not taking action to check their malpractices and to promote their benefits.

These recommendations also have not been given effect to.

The Committee of Direction, Rural Credit Survey, (1954) has suggested the following scheme for chit funds :—

(1) The larger-sized primary co-operative society should be the stakeholder of a chit fund.

(2) A particular amount, or graded amount, should be prescribed by the society as periodical (*e.g.* monthly) subscription.

(3) Membership of the chit fund should be open to all villagers, cultivators as well as non-cultivators, acceptable to the society, Those admitted should be nominal members of the society.

(4) One-third of the periodical subscription should be treated as fixed-interest-bearing deposits placed with the society itself and an individual member should be at liberty to withdraw such

1 See Central Committee Report, pp. 199-200 and Madras Committee Report, p. 219.

deposits of his after a prescribed period. This part of the contribution should not be included in the chit fund and should not figure in disbursement.

(5) Another third should be earmarked towards a 'needs fund.' The loans available from this fund should be subject to a specified ceiling. A nominal member should be eligible for a loan only when a 'need' has actually arisen, such as marriage, death or costly illness in the family. Disbursements for this purpose should be made by a committee of the society.

(6) The last third of the amount collected by subscription should be disbursed by lots.

4. *Government Tagavi Loans.*—The State provides financial assistance to agriculturists through the Land Improvement Loans Act of 1883 and the Agriculturists Loans Act of 1884. Under the former Act, long-term loans for permanent improvements on land, such as wells and embankments, are granted, while under the latter, short-term loans for current agricultural needs, such as the purchase of seed, cattle, manure, implements, etc., are granted. But the State Governments have no well-planned policy of promoting agricultural improvements by the grant of such loans, which are called Takavi or Tagavi loans, and the assistance given by them so far by these means is a small part of the finance needed by agriculturists. The loans given by all the State Governments under the Land Improvement Loans Act and Agriculturists Loans Act amount to about Rs. 35 and 60 lakhs respectively each year. The rate of interest charged on them is 6 per cent. The loans under the former Act are in practice restricted to 20 years or less, although the Act allows a maximum period of 35 years. The loans under the latter Act have to be repaid usually at the next main harvest, or after two main harvests. A longer period is allowed when special loans are given for the purchase of seed for the relief of distress.

In addition to the serious inadequacy of the amount, this system of State loans is defective in other respects also. Its administration is inelastic, and difficult to supervise. Complaints are frequently made of delay on the part of Government in dealing with applications for loans, of the levy of illegal gratifications by subordinate officials through whom loans are given and repayments are received, and of rigidity and unfairness in

realizations. Moreover, these loans are apt to be regarded by cultivators as windfalls, and so, instead of exercising any educative influence upon their character, they are apt to discourage thrift and self-help without which there can be no real improvement in the condition of the cultivators. Finally, the facilities available, and especially the procedure to be followed, are not widely known to the public. The Agricultural Commission expressed the opinion that the working of the two Acts was satisfactory on the whole, but this opinion is not shared by other authorities, including the Provincial and Central Banking Committees.

Although it is true that the executive authority in a district, however capable, cannot satisfactorily perform the duty of financing agricultural improvements within its jurisdiction, owing to the fact that the duty properly belongs to special credit institutions, the Provincial and Central Banking Committees have stated that much can be done to eliminate the defects in the administration of the Acts, and to improve and extend the benefits available to the cultivators under them. Accordingly, they have made the following suggestions :—

(1) Provincial Governments should take special steps to reduce the delay in dealing with loan applications, as the advances lose a great part of their value, if they are not given at the proper time. They should be given in the earliest stages of a famine to put heart into the cultivators and to give them moral strength.

(2) Special steps should be taken to minimise the scope for illegal gratification, and the distributing officers should be o standing and should watch for instances of exactions.

(3) If Government resources are inadequate, larger loans should be given to a smaller number of cultivators, whose needs are the greatest, so that their needs can be met more or less fully.

(4) The rate of loans per acre should be higher, so as to make it unnecessary for the recipients to resort to money-lenders.

(5) Loans for improvements should be given for a period of years, and their repayment should be insisted upon in a short period only when the amount is small, or the improvements carried out are very temporary.

(6) Suspensions or remissions should be given liberally in cases of real necessity, such as failures of crops. Dates of

repayment should be determined with due consideration of the harvest time, and loans advanced for the purchase of cattle, or in times of distress, should be made payable in more than a single instalment.

(7) The facility of these loans and the procedure to be followed for securing them should be made more widely known to the cultivators.

(8) Loans under the Agricultural Loans Act should be generally given for the relief of distress only, as Government cannot supply the entire requirements of the agriculturists and as sporadic efforts to supply a part of them cannot succeed. But in backward areas, in which co-operative credit societies cannot succeed, and in those which are specially liable to the failure of rains, the facilities under this Act should be made available to the cultivators more freely.

(9) The grant of advances under both the Acts should not be a substitute for help for famine relief.

(10) Co-operative societies may be used as mere agents for the distribution of these advances, but they should not be made responsible for watching the proper application of the loans or for their recovery.

(11) A definite policy of examining and suggesting to the cultivators agricultural improvements, and of famine protection, similar to that which is being followed in the Bijapur District of the Bombay Presidency.[1] should be adopted elsewhere, with suitable agencies for advice, guidance and supervision.

Several State Governments have realised the necessity of improving the administration of tagavi loans, and have issued instructions for making the procedure less rigid, reducing the delay in dealing with applications for loans, removing corruption, using the co-operative agency for the distribution of some of the loans, and making this facility better known to the cultivators. In the U.P. and Madras, amending Acts were passed in 1934 and 1935 to enable the grant of loans for the redemption of old debts.

1 For details see Bombay Committee Report, p. 84.

CHAPTER V

FINANCIAL NEEDS OF NON-AGRICULTURISTS

1. *Nature of their needs.*—In this chapter we shall consider briefly the financial needs of professional men and salaried servants belonging to the middle class, small traders and shopkeepers, small contractors, and industrial and other labourers, leaving to later chapters the needs of industries and larger traders engaged in internal and foreign trade.

Men belonging to the middle class need credit for making a start in different professions and occupations. Small traders and shopkeepers need it for carrying on their operations, and small contractors for carrying out their contracts. In addition, all of them and salaried servants require it for acquisition of houses and other tangible assets, and for special domestic expenditure necessitated by births, marriages, deaths, sickness and unemployment. Industrial and other labourers also need it for similar domestic expenditure. All of them have to obtain it from money-lenders, and have to pay them high rates of interest, especially if the security offered is personal.

2. *Suggestions for the organization and working of co-operative urban banks.*—The Provincial and Central Banking Committees and the Foreign Experts have expressed the opinion that co-operative credit societies of the Schultze-Delitzch type, known as urban banks, are the most suitable credit agencies for all these non-agriculturists. The scope for, and need of, co-operative urban banking are much greater in India than in Western countries, as the only form of organized banking that can be established in a majority of taluka and bazaar towns is co-operative banks, owing to the difficulty of establishing branches of the State Bank or joint-stock banks in such places and making them pay. At present the number of urban banks in the country is very inadequate. They should, therefore, be established in larger numbers wherever favourable conditions exist and should endeavour to do for these non-agriculturists what the commercial banks have been doing for the larger traders and merchants.

The size of their operations should be large, consistent with efficient management. Although the co-operative law gives them the option between limited and unlimited liability, the

liability of their members should be limited, as close mutual touch among the latter is difficult owing to scattered and extensive membership, and as their share capital would be sufficient to serve as a guarantee for borrowing. A substantial share capital should be raised in easy monthly or perodical instalments. The liability being limited, the shares need not be fully paid-up, and members may be made to take up a reserve liability up to twice the subscribed share capital, in order to provide, a safeguard to creditors in case of failure, and to increase the confidence of the investing public. To prevent the domination of a few men, individual subscriptions have been limited by law, and to prevent dividend-hunting and to build up substantial reserves, dividends have, in most provinces, been limited.

The other main source of the funds of these institutions should be deposits from members and non-members whose thrift should be encouraged by establishing savings bank departments and provident fund deposits, under which members would undertake to deposit certain fixed sums periodically. Further, the co-operative central banks should serve as financing agencies and balancing centres for them as far as possible. If, however, the former happen to be less strong than the latter, or unable to satisfy their special needs, the latter should be allowed to have direct dealings with the state co-operative bank. As these urban banks depend largely upon deposits, for their own safety as well as that of the whole organization, they should keep adequate fluid resources in the shape of easily realizable investments, or cash balances with the central or provincial bank, from which they obtain discount, rediscount, or other credit facilities, so as to be able to meet withdrawals of deposits without difficulty.

Owing to the substantial scale of their operations, they need paid establishments. Their managers must be qualified persons trained in banking because, although there is not much need for external supervision, owing to the fact that the members and the managing committees consist of educated persons, the members cannot have the same interest in these institutions that the members of agricultural credit societies can have in their societies. They should be permitted to conduct all kinds of modern advanced banking business to supply the needs of their members, such as opening current accounts, granting cash credits, dealing in cheques, collecting and discounting inland

bills, clearing, and remittance business. With the approval of the Registrar of Co-operative Societies, they may be allowed to have accounts with commercial banks, specially to facilitate their discounting, clearing, and remittance business.

Loans to members should not be given for long terms, but if the banks have sufficient funds, they may grant intermediate loans up to half of their share capital and reserve and three-fourths of their long-term deposits. As regards objects, amounts, procedure and security, the loans should be governed by conditions similar to those mentioned before in the case of agricultural credit societies. But in granting loans to wage and salary earners for unproductive uses, greater care must be exercised by the managing committees. Loans may be given on the security of gold and silver ornaments up to 75 and 50 per cent. respectively of their value, without the limitation of the maximum borrowing power of each member as fixed by the managing committees.[1] The ornaments, however, must be valued and kept in safe custody, with great care. Loans may be given to traders on the security of good and authorized warehouse receipts. Loans should be given to salary earners, whose character, income and sureties are good, on the Morris plan as far as possible, by which the borrower pays weekly instalments, and having come to borrow, remains to lend as, once the habit of saving the weekly instalment is created, it goes on.[2] Societies for salary earners should be regarded as primarily thrift societies, and credit given to them should be based on their desire and ability to practise thrift. Municipalities, other public bodies, or companies which employ them should help their societies by deducting instalments from their salaries for the recovery of their dues and subscriptions.

The organization and success of co-operative credit societies for the benefit of the labouring classes present special difficulties owing to their poverty, lack of thrift and education, migratory habits, lack of adequate security to offer, and the domination of jobbers and sardars who act as money-lenders, or are in league with them. These difficulties can be removed only gradually by education, better organization, the removal of the domination of the overseers by the appointment of labour officers, the regula-

1 *Cf.* Bombay Committee Report, p. 221.

2 For details of the Morris Plan see Central Committee Report, p. 257.

tion of migration by the grant of leave, and the active assistance of employers, who should provide substantial finance and supervision for the societies of their labourers, and who should obtain recoveries of the loans granted by the societies by means of deductions from the wages of the borrowers. Municipalities and other public bodies employing large numbers of depressed class workers should take the initiative in starting co-operative societies for their benefit. Other depressed class men may seek admission into urban people's banks, the doors of which are open to all classes.

CHAPTER VI

POST OFFICES, GOVERNMENT LOANS, STOCK EXCHANGES AND INSURANCE COMPANIES[1]

1. *Postal Savings Banks.*—Post offices supply important banking facilities to a section of the Indian population and form a part of the money market in India. The facilities take the forms of the acceptance of deposits in savings banks, the issue of postal cash certificates, the purchase and sale of Government securities without charge, and the issue of life assurance policies. Post office savings banks were first established in 1882, absorbed in 1886 the business of district savings banks which had been opened in 1870 in connection with selected district treasuries, and absorbed in 1896 the business of Government savings banks, which had been established in the Presidency towns between 1833 and 1835, and the management of which had been entrusted to the Presidency Banks between 1863 and 1865.

The number and business of the post office savings banks went on expanding, so that on 31st March 1939 there were Rs. 81.9 crores of deposits. Their progress received a temporary set-back at the outbreak of the First War when, owing to a panic, depositors withdrew large amounts. But Government soon restored their confidence by a bold policy of meeting their demands in full. Another temporary set-back came in 1930-1, when the withdrawals exceeded the deposits of the year. This was due to the economic distress caused by the increase of

1 These have been grouped in one chapter, because apart from banking proper, they provide in India the best facilities for the investment of savings.

general depression. A third set-back came during the Second War, and by 31st March 1943, the amount of deposits fell to Rs. 52.3 crores. By 31st March 1947 the amount increased to Rs. 153 crores, including Rs. 11 crores of defence savings deposits. Partition of the country caused another set-back and on 31st March 1950 the amount of deposits in the Indian Union was Rs. 40 crores, in addition to India's share of the pre-Partition amount of Rs. 146 crores. By 31st March 1962 the amount of outstanding deposits in the Indian Union had increased to Rs. 340 crores and the number of depositors was $84\frac{1}{2}$ lakhs.

These banks are to be found throughout the country in all head post offices, all sub-post offices, and some branch post offices. Their main object has been to promote thrift among the working and middle classes. The majority of the depositors, however, belong to the middle class—professional men, servants of Government and public bodies, teachers, etc. The agricultural and industrial workers have not yet begun to use these banks to any extent. These banks must not be used for keeping current accounts, and the Deputy Accountant-General of Posts and Telegraphs can close any accounts, which, he thinks, are used for a purpose other than that for which they are meant to be used. The net deposits into an account in a single year are limited to Rs. 750, and the total amount that can be kept in it is limited to Rs. 10,000 in the case of an adult and to Rs. 1,000 in the case of a minor, on whose behalf an account can be opened by his relative or guardian. Amounts of 1 Rupee and above can be deposited at any time, but withdrawals from the account are not allowed more than once a week. A pass book is supplied to every depositor in the vernacular of the locality, or in English, according to his desire, and it must be presented at the time of making every deposit or withdrawal. The rate of interest was 3 per cent. per annum, until 1933. It was then rduced to $2\frac{1}{2}$, to 2 in 1935, and to $1\frac{1}{2}$ in 1938. After the war, it was gradually raised and became 3 per cent per annum again in 1962. It is calculated for each month on the lowest amount in an account between the end of the fourth day and the end of the month. In 1955, the Indian Parliament enacted legislation permitting Government to give the public the facility of withdrawing money from, and depositing it into, savings bank accounts by means of cheques. Government has given this facility in selected post offices and will extend it gradually according to experience.

2. *Suggestions for improving the facilities given by postal savings banks.*—The Central Committee and some Provincial Committees have suggested that permission should be given to the public to open joint accounts in the names of two persons, payable to either or survivor, and that a depositor should be allowed to name a nominee to whom payment of the deposit should be made on his death, thereby avoiding the delay that is caused by the existing procedure requiring an examination of the legal position of his heirs.

Some of the Provincial Committees and Mr. Subedar have also made the following recommendations :—

(1) The number of post offices where savings bank business can be transacted should be increased.

(2) Where it would not pay to keep such post offices open throughout the week, they may be kept open for two days of the week, and administered by being grouped with other post offices in the neighbourhood.

(3) The services of the village school masters should be used as far as possible for running them.

(4) Unrestricted withdrawals from savings bank accounts should be permitted as from current accounts with banks and, if this is not possible, at least more frequent withdrawals should be permitted.

(5) Facilities for transfer of money from one savings bank account into another should be given.

(6) The accounts should be kept in English or the local vernaculars, at the option of the depositors.

(7) Heads of factories and offices should arrange to deposit money in, and to withdraw it from, the accounts on behalf of employees who cannot go to postal savings banks during working hours.

(8) A limited number of postal savings banks should be kept open in the larger towns two or three evenings of the week, in order to afford adequate facilities to labourers and small shop-keepers, etc. to make use of them.

3. *Postal cash certificates and defence and national savings certificates.*—Post office cash certificates were issued from the time of the First War for stimulating thrift and saving, and succeeded in drawing out a considerable amount of the savings of persons

of moderate means, who desired to obtain a maximum yield with minimum risk, and who were little attracted by other forms of investment. The certificates matured after 5, 7 or 12 years from the date of issue, and were payable in Rs. 10 or multiples of Rs. 10. Rs. 25,000 was the maximum limit for the face value of the certificates that a person could hold at any time. The difference between the purchase price and the maturity yield provided interest free from income-tax, and the purchase price was so altered at intervals according to the conditions of the money market, that the interest yield varied between 6 and 2½ per cent. per annum. From 1936 the purchase price yielded 2½ per cent. compound interest. The certificates could be cashed at any time before maturity, but no interest was paid if they were cashed within a year from the date of issue, and the interest rate rose progressively from the second year, the full rate being paid only at the end of 5 years.

Investments in the certificates varied in amount according to the rate of interest obtainable and the economic condition of persons of moderate means. In 1940, Ten Year Defence Savings Certificates were introduced. From October 1943 they were replaced by National Savings Certificates, the value of a Ten Rupee certificate being Rs. 15 at the end of 12 years, free of income-tax, and the total face value of certificates held by any person being limited to Rs. 5,000. Ten Year National Plan Certificates were issued from May 1954. Both were replaced by Twelve Year National Plan Savings Certificates from June 1957. Treasury Savings Deposit Certificates, interest on which is payable annually have also been issued. The outstanding amounts of National Savings Certificates, Ten Year Plan Certificates, Twelve Year Plan Certificates and Treasury Certificates on 31st March 1962 were Rs. 68, 17, 348 and 53 crores respectively.

The Central and Bombay Banking Committees have recommended that a holder of the cash certificates should be allowed to nominate a person to whom their value would be paid on maturity, in the event of his death, as this facility would increase their popularity.

For the special protection of women, the Central Areas Committee has suggested the issue of special certificates, which can be held by women only, the interest on which should be payable to the holders every year through the nearest post office,

and the principal of which should be repayable to them only after 10 years. The Central Committee has supported this recommendation in principle.

4. *Facilities given by post offices for the purchase, sale, and custody of Government securities.*—The post offices also give important facilities to the public for the purchase and sale of Government securities. Any individual, even if he has not previously been a depositor in a post office savings bank, can invest money, free of charge, through a post office in any loan issued by the Government of India up to a maximum of Rs. 5,000 in each official year after deducting any amount sold through the post office. Funds for such investment can be provided either from the amounts previously deposited in the investor's savings bank account, or from money specially deposited by him for the purpose, or from both. The post offices also sell on behalf of an investor at the prevailing prices, and free of charge, the whole or a portion of the Government securities that he has purchased through post offices, whether they are held by him or by the Deputy Accountant-General of Posts and Telegraphs on his behalf, provided that he is a savings bank depositor at the time, and that, if only a portion is to be sold, the balance that would be left has the face value of Rs. 100, or multiples thereof.

An investor can either take delivery of the Government securities purchased for him by a post office, or leave them in the custody of the Deputy Accountant-General of Posts and Telegraphs. In the latter case, a maximum limit of Rs. 22,500 is imposed, but it applies only to securities that are issued as liable to income-tax, and does not include securities that have been issued tax-free.

Post offices do not make any charge for the purchase, sale, safe custody, or delivery out of custody, of Government securities bought through them, or for the collection and payment of interest on such securities. As long as the securities remain in the custody of the Deputy Accountant-General, the interest on them is free from income-tax. The Assam and Central Banking Committees have stated that these facilities are not sufficiently known to the public, and that, if greater publicity is given to them, they will be used by a large number of small investors.[1] The latter has further expressed the opinion that

1 See Assam and Central Committees Reports, pp. 216 and 442.

they will be used more widely, if they are given to small investors generally, and are not limited to savings bank depositors.

5. *Postal Insurance.*—Finally, the post offices provide insurance facilities to permanent servants of Government, local bodies, and Universities recognized by Government. They are first, life insurance, *i.e.* payment of a certain amount on the death of an insured person to his legal representatives or assigns; second, endowment assurance, *i.e.*, payment of a certain amount to a person when he reaches a particular age, or to his legal representatives or assigns at his death, if he dies before reaching the particular age; and third, monthly allowances commencing at once or from a particular date in future. The minimum and maximum limits of life insurance and endowment assurance policies are Rs. 100 and 20,000 respectively, and those of monthly allowances are Re. ½ and Rs. 50. The premia for the policies have to be paid monthly, and for the monthly allowances, either a lump sum or monthly instalments spread over a number of years have to be paid. The premia or the instalments are deducted from the salaries by the employers, and are remitted to the post office department.

The Assam and Madras Banking Committees have suggested that these insurance facilities should be thrown open to the public, but the Central, Bengal and Bombay Committees have not supported the suggestion on the ground that a large number of local life insurance companies already supply similar facilities to the public. Postal insurance policies would, however, command more public confidence than policies issued by companies, and would stimulate savings in the form of insurance by the public. Insurance companies cannot object to the proposal, if the postal premia rates do not compete unfairly with their rates, and if postal insurance facilities are restricted to persons of moderate means.

6. *Government loans.*—Government rupee loans also play a fairly important part in the money market in India. They take three forms, *viz.* stock certificates, promissory notes, and bearer bonds. The ownership of stock certificates is registered at the Public Debt Office, and can be changed only by registration in that office. Interest warrants are sent half-yearly to the registered owners, who do not have to present the stock certificates. The ownership of promissory notes can be

transferred by endorsement in the space provided for the purpose on the back of the notes, which have to be presented to receive interest warrants. The ownership of bearer bonds can be transferred by mere delivery from hand to hand, and their value is paid to the bearer on the date of maturity without any formality. Interest coupons are attached to the bonds, and are detached and presented for payment by the owners when they become due. These forms of Government securities are interchangeable. The fee for conversion is 4 annas per cent. on securities of a face value of not more than Rs. 400, and one rupee per security of a face value exceeding Rs. 400, except in the case of the conversion of promissory notes or bearer bonds into stock certificates, for which no fee is charged. The issue of bearer bonds has, however, been recently discontinued by Government, as it was believed that they were not popular. These securities are either non-terminable, *i.e.* repayable only at the option of Government after giving notice, or terminable, *i.e.* repayable on a specified date, or repayable not earlier than a specified date and not later than another specified date.

When Government desires to borrow, it publishes a notification in its *Gazette* and newspapers giving all the details of the loan that it wishes to float, such as the issue price, the rate of interest, the dates of issue and closing, the method of repayment and repayment at par or premium, and inviting applications for subscriptions, which have to be sent to the offices of the Reserve Bank, branches of the State Bank and Government Treasuries.

Before the First War, the bulk of the loans used to be raised in England on the grounds that the difference between the rates of interest in India and England was so substantial as to more than counterbalance the drawbacks of borrowing in England, and that the resources of the money market in India were so limited that it could not lend more than Rs. 5 crores to Government annually. The last War and post-War periods proved that this view was not correct. During these periods Government had to borrow very large amounts to pay India's War contributions and to meet the expenses of the construction of New Delhi, the new capital, and the successive budgetary deficits of 5 years. But it had to borrow most of this amount in the money market in India, as the capacity of the English

money market was more or less fully taxed by the English Government for its own exceptional and enormous needs.

The strength of the money market in India was revealed by the fact that it contributed Rs. 53 and 57 crores to the loans that Government floated in 1917 and 1918 respectively. This strength was largely maintained after the War. Government was able to borrow between Rs. 20 and 30 crores annually in India, and so it did most of its borrowing in the country itself. The number of investors in these loans also increased to a considerable extent owing to more effective advertisement and the offer of larger facilities for the administration of the loans at Government treasuries and sub-treasuries. During the Second World War, the various Defence, Victory or Development Loans yielded Rs. 51, 56, 41, 142, 211 and 308 crores and sales of rupee counterparts of sterling loans, mostly to institutional investors, yielded Rs. 61, 22, 48, 78, 15 and 6 crores in 1940-1, 1941-2, 1942-3, 1943-4, 1944-5 and 1945-6 respectively. In the succeeding years, however, the loans yielded much less owing to a heavy fall in the saving capacity of the middle and upper classes. On 31st 1949, the total public debt of India amounted to Rs. 3,408 crores, out of which the outstanding treasury bills amounted to Rs. 354 crores and the sterling obligations to Rs. 30 crores. The increase of Rs. 1,026 crores in the rupee debt during the War reflected the results of revenue deficit, capital expenditure and repatriation of sterling debt. The great decline of the sterling debt to Rs. 30 crores was due to its repatriation, made possible by the large accumulation of sterling balances in favour of the Government of India, which made very large war payments in Indian currency on behalf of the English Government.[1] After the introduction of provincial autonomy in 1937, several Provincial Governments borrowed in the money market, and their total funded debt amounted to Rs. 47 crores on 31st March 1949. On 31st March 1962 the total interest bearing obligations of the Government of India in India amounted to Rs. 6,793 crores, consisting of loans, treasury bills, small savings, reserve funds, investment of U. S. Government Counterpart Deposit Funds and others amounting to Rs. 2669, 1782, 1064, 98, 300 and 370 crores respectively. On the same date, the external debt owed to the U.S.A., U.K., U.S.S.R.,

1 See the Reserve Bank of India Report on Currency and Finance 1942-3, p. 47,

West Germany and other foreign countries amounted to Rs. 710, 121, 88, 108, and 157 crores respectively. On 31st March 1962 the total debt of the States amounted to Rs. 3072 crores consisting of permanent debt, floating debt loans from Central Government, other debt and unfunded debt amounting to Rs. 570, 20, 2276, 62 and 144 crores respectively.

The market prices of Government securities and the interest yield from them have fluctuated considerably in recent years. As banks have large holdings in Government securities, depreciation in their value has appreciably hampered the operations of the banks. For several years before the First War the prices ruled high and the yield was low, because Government borrowings were comparatively moderate, and its credit was high. But during the First War and post-War periods, the prices went down substantially, the yield increased, and new loans had to be floated at appreciably higher rates of interest, as Government borrowings became large, its credit went down owing to the uncertainties of War and budget deficits, and the counter-attraction of newly issued industrial securities was large.

From 1925 to 1929 the prices improved and the yield diminished, as Government credit improved with the balancing of the budgets, and as the counter-attraction of industrial securities diminished much after the failure of many companies. But during 1929-32 the prices fell again, the yield increased, and new loans had to be issued at higher rates, as a wave of dear money swept over the world, and as Government credit deteriorated once more owing to budget deficits and disturbed political conditions in the country. The situation improved very much from the middle of 1932, and by 1936 the prices of Government securities rose above the level at which they had been at the outbreak of the War, and Government was able to float a large loan successfully at 3 per cent. which was ½ per cent. less than the pre-War rate of interest. This was due to balanced budgets, improved political situation in the country, heavy gold exports and diminution of the counter attraction of industrial securities on account of the economic depression. During the Second War, prices declined once more, whenever the military situation became unfavourable for the Allies, *viz.* the collapse of France, the extension of the War to the Balkans, the advance of the enemy in Russia or North Africa and the outbreak of hostilities with Japan, but from March 1942, Government fixed

minimum prices under the Defence of India Rules, and from 1943, with the turning of the tide in favour of the United Nations the prices rose and reached the pre-War level. Then Government pursued steadily and progressively what was called "the cheap money policy", *i.e.* the policy of borrowing at progressively lower rates of interest, until by the end of 1946 the rate of interest on unredeemable loans as well as redeemable loans, long-term, medium-term and short-term, was reduced to 3, 2¾, 2½ and 2¼ respectively. The prices of the loans that had been issued before at higher rates of interest, therefore, rose to an appreciable extent. From 1947, however, the cheap money policy received a set-back and by 1950 the Government had to raise the rate of interest on medium-term borrowing to 3 per cent. After the raising of the bank rate in 1951, the Government of India and the State Governments had to raise the rate of interest on medium-term borrowing to 3½ and 4 per cent. respectively. Consequently, the market prices of previous loans fell. The gilt-edged market remained rather weak, on the whole, until 1957, in spite of the support of the Reserve Bank to it. It became firm in 1958 owing to the increase of money supply brought about by the plan disbursements and to larger investments of banks, which found that their depositss increased faster than their advances. It became weak again from 1961, as banks reduced their investments in Government securities on account of a large increase in the demand for advances from them. It ceased to be active and banks could sell the securities to and buy them from the Reserve Bank only. Moreover, in 1962 the Central Government and the State Governments had to raise the rate of interest on medium-term borrowing to 4 and 4½ per cent. respectively.

The Municipal Corporations and Port Trusts of the most important seaports of India, *viz.* Bombay, Calcutta, and Madras, and the Improvement Trusts of Bombzy and Calcutta have floated large loans from time to time. The total amount of the outstanding loans of these bodies at present is nearly Rs. 140 crores.

7. *Organization and working of stock exchanges in Bombay and Calcutta.*—There are only three stock exchanges in India, in Bombay, Calcutta and Madras. All Government securities, the shares of important industrial, banking, railway, and other companies situated in different parts of India, and the bonds

issued by the Municipal Corporations, Port Trusts and Improvement Trusts of the main seaports of India are quoted on these exchanges, which transact a fairly large amount of business every working day. The bulk of the business of the Bombay Exchange is, however, in connection with cotton mill shares, and that of the Calcutta Exchange, with jute, tea and coal shares.

Speculation in these markets has been considerable in recent years. During the industrial boom created by the First War and post-War conditions, all sorts of new companies were formed, the shares of many of them were over-subscribed, and those of the older companies went to a heavy premium. Many people transferred their energies from other occupations to these exchanges, hoping to amass fortunes quickly by heavy speculation. When the tide turned and the crash came, many of the new companies went into liquidation, many operators failed or suffered heavy losses, and there was great discontent. The orgy of speculation was much more intense on the Bombay Exchange than on the Calcutta Exchange, and public confidence in the former was rudely shaken. In 1923, therefore, the Government of Bombay had to appoint a committee presided over by Sir Wilfred Atlay to investigate the constitution and working of the Bombay Exchange. In 1936 another committee presided over by Mr. Morrison was appointed. During the Second War also there was much speculation, especially on the Bombay Exchange, until control was established by Government. During 1946 speculation was very large.

The Bombay Stock Exchange, called the Native Share and Stock Brokers' Association, or the Bombay Share Bazaar, formally came into existence in 1897, although informally it functioned much earlier. The majority report of the Atlay Committee, signed by all the members except one, made several recommendations for improving its working, preventing corners, and checking wild speculation, such as the tightening of discipline, facilitating the handling of legitimate complaints made against the brokers by the public, increase of business hours, reduction of holidays, discontinuance of sub-brokers, annual election of the Board, and annual declaration by members of the kind of business they intended to transact. But the Association accepted the minority report which made unimportant recommendations, so that little change was made in the

constitution and working of the Exchange. But another orgy of speculation in 1925 brought another crash, public opinion was roused, Government threatened intervention and control, and the Association had to reform its rules for the purpose of checking speculation and preventing similar crises in future, and to get them sanctioned by Government. The Morrison Committee also made further recommendations for checking speculation, and the Association has accepted some of them.

Any Indian, or any Britisher who has lived in the Bombay State for ten years previously, can apply for membership of the Association, but to secure a high degree of business morality, admission is severely restricted. The number of members is restricted, and an entrance fee, called the value of a membership card, is charged, ranging from Rs. 40,000 in 1921 to Rs. 30,000 at present. A prospective member must have substantial property and unimpeachable credit, his application must be supported by at least two-thirds of the members, objections against him are invited and examined, the application can be rejected without giving any reason, and cannot be resubmitted for two years. The number of members at present is 475. All of them are brokers, and they must not have subsidiary business interests in any other association. But nearly a quarter of the active members are also commission agents.[1]

The Association has strict rule for controlling the conduct of its members, and for dealing with default or fraud on their part. The Board of the Association is empowered to fix the prices of securities in an emergency. There is a Committee of Default, which decides whether a member is a defaulter. A member who is declared by it to be a defaulter has to submit to it his account books, papers, balance-sheet, and a statement of his business transactions left incomplete. To prevent fraud, the rules prohibit fictitious orders, and lay down that the members must accept all orders, large as well as small, from their clients, and must have no 'bucket shop' dealings or trading in differences of quotations, and that, although the members may transact business for themselves, they must not make any improper use of their clients' securities that may be in their charge.

To facilitate the detection of fraud, the rules provide that the members must keep uniform registers on the prescribed basis,

1 *Cf.* Jain, *The Monetary Problems of India*, p. 147 and Indian Year Book, 1939, p. 725.

that they must enter in them all the details of their transactions at the end of every working day, and that the registers must be open to examination by the Board of Directors. An Arbitration Committee exists to consider cases of alleged fraud, and can expel members from the Association if they are found guilty. During the entire history of the Association, however, there has been hardly any case of fraud by a member, and a high level of business integrity has been maintained by its members.

Every member is allowed to have four clerks, and conducts his transactions with their help. Every transaction must be entered in a memorandum book as soon as it is made. At the end of each working day, all transactions carried out during its course must be entered in two registers in accordance with the entries made in the memorandum book. The first register is for recording all dealings with the members only, and is very elaborate for the purpose of removing all chances of mistakes. The other register is for recording all transactions carried out on behalf of customers in their names, and is less elaborate. The customers are mainly of three kinds. Firstly, there are the investors whose only object is to invest their savings, and to obtain a more or less steady income permanently. Secondly, there are the rich clients who finance needy brokers for a month at a time at high rates by means of what are known as 'badla' transactions. Finally, there are the speculators who watch the fluctuations in the market quotations from day to day, and operate as 'bulls' or 'bears'. The Bombay Stock Exchange continues to have numerous holidays, which come to about one-fourth of the entire year, although a substantial reduction in them was suggested by the Atlay Committee. A second stock exchange, known as the Indian Stock Exchange Ltd., has been functioning in Bombay to a small extent since 1938.

The Calcutta Stock Exchange was established in 1908, but the Association, which has been managing it, was registered under the Indian Companies Act only in 1923. It has at present a paid-up capital of Rs. 2.22 lakhs, with 222 members, consisting of firms with 602 partners and assistants, all of whom act as brokers. The share-holders annually elect a Managing Committee consisting of an equal proportion of Europeans, Bengalees and Marwaris, and the Committee appoints several Sub-Committees and the President and Secretary. This Association

also has strict rules for controlling the conduct of its members and for dealing with default or fraud on their part. Its Committee settles disputes betweeen the members, making it unnecessary for them to resort to the courts of law.

A stock exchange was established in Madras in 1920, but its working members were few, its business did not expand as there was little speculation, the number of its working members gradually fell off, and so it had to be closed. The business of investment in Government, industrial, and other securities was then conducted by three firms. Since 1937 another stock exchange has been functioning in Madras.

No regular stock exchanges exist in the country other than those in Madras, Bombay, Calcutta and Ahmedabad. Their absence hampers the growth of joint-stock enterprise and investors, but without sufficient business, no exchange can be formed in any centre. The commercial banks, co-operative banks, loan offices, Chit Funds and Nidhis can do much to lessen the handicap created by the absence of local exchanges, by taking up the work of purchasing and selling securities for their clients on a commission basis.

8. *Insurance Companies and Life Insurance Corporation of India.*—Until they were nationalized and absorbed by the Life Insurance Corporation of India, owned by the State, in 1956, life insurance companies played an important part in the banking system of India, as they held for long periods a substantial part of the savings of the people, encouraged and mobilized their savings like savings banks, and made them available to commercial and industrial companies, public bodies and Government for beneficent purposes. In November 1954, the total number of companies doing life, fire, marine and other classes of insurance business in India was 319, out of which 215 were Indian and 104 foreign, 65 being British, and 21 being constituted n the British Dominions and colonies. Of the 215 Indian companies, 88 had their head offices in Bombay State, 45 in West Bengal, 30 in Madras and 20 in Delhi. Of the Indian companies, 113 carried on life assurance business only, 41 carried on life business along with other kinds of insurance business, and only 61 carried on insurance business other than life. Of the foreign companies only 3 confined themselves to life business, 13 carried on life business along with other kinds

of insurance business and 88 carried on insurance business other than life. Their total net premium income for 1953 was Rs. 52 crores, of which Rs. 7.8 crores went to foreign companies. The total assets of Indian companies at the end of 1953 amounted to Rs. 293.9 crores and the total sum of life insurance assured and bonuses by all companies amounted to Rs. 962 crores, out of which the amount assured by Indian companies was Rs. 830 crores.[1] On 31st December 1961, there were 155 companies, 82 Indian and 73 non-Indian doing fire, marine and miscellaneous insurance business. The total assets of the Indian companies amounted to Rs. 64 crores and those in India of the non-Indian companies amounted to Rs. 12 crores and their total net premium income was Rs. 33 and 8 crores respectively.

The companies lend a portion of their resources to their policy-holders, and invest a considerable portion in Government and trust securities and treasury bills. Some of the Indian companies also purchase shares and debentures of banks and companies and debentures of co-operative banks, invest a portion of their funds in mortgages of land and buildings or in land development, and keep deposits with, or give loans to, banks and loan offices, which in turn finance cottage industries. There was a large field for the spread of the operations of life insurance companies in rural areas and among landowners, to be opened up by wise canvassing and sound financial enterprise. During 1930-37 the number of Indian life assurance companies increased by 120. Unfortunately, however, in the rush to exploit this field, a few of the companies resorted to unsound financial methods and their agents offered uneconomic inducements to clients, so that 50 companies had to be liquidated in recent years. Moreover, some companies did not submit annual returns of their business and position to Government as required by the Indian Life Assurance Companies Act of 1912 and the Indian Insurance Companies Act of 1928, because the Acts did not lay down a sufficient penalty for failure to submit annual returns. The Insurance Act, therefore, was passed in 1937 and improved in 1946 to prevent the formation and working of insurance companies on unsound lines.

As the Government of India took the view that the above legislation had not succeeded in stopping the unsound practices of some of the Indian life insurance companies, it got Parliament

1 See the Indian Insurance Year Book, 1961 pp. 1, 3 and 4.

to pass the Life Insurance Corporation Act in 1956, which created the Life Insurance Corporation of India and compelled the absorption by it of all life insurance companies. The corporation consists of 15 members, who are authorized to manage its affairs on business principles, subject to such directives on matters of policy as the Central Government may give from time to time. The Corporation is charged with the duty of functioning in such a manner as to secure that life insurance business is developed to the best advantage of the community. The other authorities of the Corporation are the Executive Committee, Investment Committee, Managing Directors and Zonal Managers. In addition to the central office located in Bombay, there are 5 Zonal officers at Bombay, Calcutta, Delhi, Kanpur and Madras, and a number of divisional and branch offices.

In 1960, the completed new business of the Corporation was Rs. 497.54 crores under 12.58 lakhs policies. In 1961, its completed new business was Rs. 608.82 crores under 14.70 lakhs policies. 10.24 lakhs policies were taken by persons who were insuring their life for the first time. 5.3 lakhs policies, assuring Rs. 182.59 crores, were issued to persons living in rural areas. The total business of the Corporation in force at the end of 1961 was Rs. 2,737 crores under 86 lakhs policies. In 1961, the ratio of net lapses to the mean business in force was 7 per cent. The premium received in 1961 was Rs.112.30 crores, as against the total premium of Rs. 58.55 crores received by all life insurance companies in 1955, which was the year preceding the establishment of the Corporation. Its total income in 1961 was Rs. 141 crores and its life fund at the end of 1961 was Rs. 631.59 crores. Of its total investments in India amounting to Rs. 503.56 crores, 77.9 and 22.1 per cent. were in the public and private sectors respectively. During the year, 52 new issues of shares and debentures, involving a total of Rs. 7.59 crores, were underwritten by it. Its total assets at the end of 1961 amounted to Rs. 696.31 crores. The net increase in its assets, from its inception in 1956, amounted to Rs. 281 crores.

The completed new business from 1953 to 1961 was as follows :—

Year	In India		Outside India	
	No. of Policies issued	Sum Assured (crores of Rs.)	No. of Policies issued	Sum Assured (crores of Rs.)
1953	5,74,749	156.26	30,441	14.66
1954	7,40,093	237.60	32,682	17.65
1955	7,96,030	240.51	35,461	20.33
1956	5,49,401	187.69	17,956	12.59
1957	8,10,738	277.67	5,055	5.40
1958	9,54,771	339.06	5,399	5.62
1959	11,43,387	419.70	7,912	9.47
1960	12,49,821	487.84	7,736	9.70
1961	14,61,608	598.79	8,056	10.03

From 1957, the business under Janata Policy Scheme has been included.

CHAPTER VII

COMMERCIAL BANKING : INDIAN JOINT-STOCK BANKS

1. *Their organization.*—Indian joint-stock banks are those registered in India under the Indian Companies Act. They are subject to the Indian Banking Companies Act 1949 also.

The following were the assets and liabilities, in crores of Rupees of the more important banks on 31st December, 1961.[1]

They may be called the ' Big Seven ' as their deposits are more than Rs. 50 crores in each case. The Central Bank of India, the Bank of India, the Punjab National Bank, the Bank of Baroda and the Allahabad Bank used to be called the ' Big Five ' of India until a decade ago, after the ' Big Five ' of Great Britain.

The Central Bank of India, the bigger of the Indian banks, was established in 1911 by Sir Pherozeshah Mehta and developed by Sir Sorabji Pochkhanawalla. It absorbed the Tata Industrial Bank in 1923 and has made excellent progress, in spite of the attacks of enemies and the 9 runs engendered by them. It has pursued a very active policy of branch expansion and shares with the State Bank and the Punjab National Bank the honour of having branches in all parts of India. Its dividend has been 14 per cent.

1 See Statistical Tables relating to banks in India 1961.

Name of Bank	Paid-up Capital	Reserves	Deposits	Other Liabilities	Profit	Total Assets or Liabilities	Cash In hand and with Reserve Bank and State Bank	Balance with Other banks	Bills discounted and purchased	Loans and Overdrafts	Investments	Premises and Other assets	No. of Offices
1. Central Bank of India Bombay 1911 ..	3.15	4.13	220.19	43.28	1.83	272.58	18.33	5.58	40.91	135.79	58.80	23.26	333 (10)
2. Punjab National Bank, Delhi, 1894 ..	2.00	2.11	150.68	49.15	1.18	205.12	12.65	4.69	13.43	79.79	45.53	49.13	365 (3)
3. Bank of India, Bombay, 1906	3.00	3.28	126.02	14.65	1.23	147.18	9.60	1.90	17.34	83.02	22.24	12.90	63 (12)
4. United Commercial Bank, Calcutta, 1943 ..	2.00	2.35	98.90	45.37	.73	149.35	6.09	1.77	21.76	42.45	35.97	41.31	140 (13)
5. Bank of Baroda, Baroda, 1908	1.50	1.81	95.46	23.38	.68	122.83	6.37	.70	11.99	58.38	24.90	20.68	140 (11)
6. United Bank of India,	2.69	.91	58.87	13.28	.20	75.87	5.06	.54	6.68	37.61	17.70	8.28	98 (15)
7. Allababad Bank, Calcutta, 1923	.47	1.08	57.41	5.43	.22	64.61	4.58	5.08	2.81	31.63	17.51	3.00	88

The number in brackets in the last column shows the number of offices outside the Indian Union.

The Bank of India, established in 1906, has until recently pursued a very cautious policy of expansion, and among the 'Big Seven', has the fewest branches, which are concentrated in a few big commercial and industrial centres, largely in the State of Bombay. It is one of the few fortunate Indian banks that have escaped the activities of professional 'credit wreckers' in the country, and so far has suffered only a single run upon it. It is now pursuing a vigorous policy of expansion and pays a dividend of 20 per cent.

The Allahabad Bank is the oldest among "Indian" banks, having been started at Allahabad in 1865. But it has grown only since the end of the last century. In 1922 it was bought out by the P. and O. Bank, which was latter amalgamated with the Chartered Bank. Even before 1922 it was largely controlled by non-Indians. Since 1922, such control has been complete. In 1923 its head office was transferred to Calcutta, but its operations are still chiefly in the U. P. and Punjab. Its rate of dividend was maintained at 16 per cent. for many years and has now been increased to 18 per cent.

The Punjab National Bank is one of the few really Indian banks that have survived from the last century. It was started in 1895. Th banking crisis of 1913-14 was a great ordeal for it, and its deposits were reduced to half. But afterwards it gradually recovered and increased its strength. The bulk of its deposits are fixed and savings deposits. Its rate of dividend used to be 12 per cent. before the Depression. Then it was reduced to 6 per cent., but is now 16 per cent.

The Bank of Baroda was established in 1909 with the support of that State. Its operations are largely in Gujarat and Saurashtra. In 1925 and 1933 it suffered from runs on account of false rumours of the withdrawal of State funds and support. Recently it has absorbed the New Citizens Bank of India Ltd., having many branches in Maharashtra, and opened some branches in other parts of the country also. Its dividend rate was steady at 10 per cent. and is now 16 per cent.

The United Commercial Bank was started in 1943 by Birla Brothers. Under able management it has made rapid progress and pays 7 per cent. dividend.

The United Bank of India was formed in 1950 by the amalgamation of the Comilla Banking Corporation, the Comilla Union Bank, the Bengal Central Bank and the Hooghly Bank. It pays only 6 per cent. dividend.

COMPARATIVE PERCENTAGE OF CERTAIN ITEMS IN THE BALANCE SHEETS AND PROFIT AND LOSS ACCOUNTS OF THE EIGHT LARGEST INDIAN BANKS, AS AT 31ST DECEMBER 1961.

	Percentage of Total Earnings, to Total Working Funds	Percentage of Net Profits, after providing for Taxation, to Total Working Funds	Percentage of Salaries, Allowances & Provident Fund to Total Working Funds	Percentage of Interest and Discount to Total Earnings	Percentage of Commission, Brokerage etc. to Total Earnings	Percentage of Interest paid on Deposits, Borrowings etc. to Total Earnings.	Percentage of Salaries, Allowances & Provident Fund to Total Earnings	Percentage of Balance of Profit to Total Earnings	Percentage of Total Advances to Deposits	Percentage of Dividends to Shareholders to Total Earnings	Percentage of Dividends ot Shareholders to Net Earnings
1	2	3	4	5	6	7	8	9	10	11	12
1. State Bank of India	3.61	0.49	1.46	71.52	27.33	34.90	40.40	13.72	48.05	6.55	44.05
2. Central Bank of India	5.38	0.80	1.77	83.10	16.02	43.03	32.96	14.94	73.12	5.15	34.46
3. Punjab National Bank	5.92	0.77	2.12	79.97	17.78	40.55	35.75	12.93	61.86	3.14	24.28
4. Bank of India	4.64	0.84	1.23	83.71	14.61	42.70	26.47	18.11	78.81	9.85	54.40
5. United Commercial Bank.	5.44	0.70	1.51	73.07	25.36	46.43	27.85	13.00	64.92	4.27	33.05
6. Bank of Baroda	5.20	0.79	1.39	82.17	17.21	47.60	26.63	13.16	73.72	4.96	37.70
7. United Bank of India	4.77	0.33*	2.30	79.77	14.51	29.92	48.31	6.58*	63.89	5.40	78.39*
8. Allahabad Bank	5.67	0.38	1.84	86.27	13.10	46.18	32.39	6.73	55.10	2.00	29.61

In the case of this Book, net profits are arrived at after providing not only for taxation, but also bonus to staff.

The Foreign Experts associated with the Central Banking Committee expressed the opinion 30 years ago that, taking into account the predominantly agricultural character of India the prevailing stage of its economic development, the number of credit agencies, including indigenous bankers, and the amount available for the granting of credit could not be said to be insufficient; that no bank, unless compelled by law in return for benefits conferred, could be expected to extend its activities and to open branches in new places, unless they offered it a fair prospect of reasonable profits in the near future ; that the immediate problem in connection with banking in the country was not one of expansion, but of the organization, consolidation and co-ordination of the existing banking agencies which were marked off into different classes, each doing a distinct kind of business without sufficiently close relations with the others; and that it was only later that a considerable increase of banking facilities would be required in accordance with the development of the economic and financial life of the country and, therefore, with the growth of banking possibilities, without which no modern banking facilities could be expected.

The general opinion, however, until very recently was that the progress of Indian joint-stock banking was uneven in the country, and not in keeping with the needs of its different parts, and that the banks were slow in establishing branches.

The figures shown in the table on p. 167 bring out the position of the cash balances of these banks.

The position, as a whole, has not been unsound, in spite of the reduction in the percentage in several years. The reduction was accompanied by an increase in the holdings of the banks in Government securities. The creation of a forward market in them has helped to reduce the fluctuations in their prices, and to sell them without much loss, and also the practice of the banks, of obtaining loans from the State Bank against them, in case of need, increased during post-War periods of tight money. They can obtain such loans now from the Reserve Bank, if necessary. Moreover, when the banks obtain deposits from several areas wide apart from each other, and when they have a reasonable expectation that the growth of public confidence will enable them, not only to renew the deposits, but also to tap new sources of deposits, and to obtain a constant

PERCENTAGE OF CASH TO DEPOSITS AT THE END OF EACH YEAR

Year	Banks having capital and reserve of Rs. 5 lakhs and over	Banks having capital and reserve be-ween Rs. 1 and 5 lakhs	Year	Banks having capital and reserve of Rs. 5 lakhs and over	Banks having capital and reserve be-tween Rs. 1 and 5 lakhs
1918	23	24	1940	23	18
1919	21	24	1941	19	21
1920	23	18	1942	23	28
1921	20	13	1943	24	32
1922	20	17	1944	21	36
1923	17	19	1945	20	34
1924	21	13	1946	19	26
1925	19	20	1947	21	22
1926	15	24	1948	19	18
1927	13	15	1949	18	17
1928	13	15	1950	17	18
1929	14	13	1951	17	20
1930	12	12	1952	16	17
1931	12	12	1953	15	17
1932	13	17	1954	15	18
1933	15	17	1955	13	17
1934	15	14	1956	12	16
1935	23	16	1957	13	15
1936	16	18	1958	11	16
1937	17	16	1959	11	15
1938	14	15	1960	11	15
1939	17	15	1961	10	15

flow of funds, some reduction in the proportion of their cash to liabilities is justified. Finally, the facility of re-discounting bills, which is now given to them by the Reserve Bank, makes their position sounder in this respect.

2. *Operations of Indian Joint-stock Banks.*—The main business of these banks is to attract deposits, current, fixed and savings, and to finance trade by giving short-term advances against easily realizable securities, opening cash credits, and discounting inland bills of exchange. They also finance the movement of produce from the village to the exporting ports and imports from the ports of entry to the distributing centres. Their business, so far as agriculturists are concerned, is usually confined to the larger landholders, the planters, and others who can offer tangible and marketable security. They paid 4 or 5 percent. interest on fixed deposits for a year, and 2 and 2½ per cent. on current accounts, during the slack and busy seasons respectively, provided that a minimum monthly balance

of Rs.200 or 300 was maintained; but, on account of the economic depression, they reduced these rates to 2 or $1\frac{1}{2}$ per cent. on fixed deposits and $\frac{1}{2}$ per cent. on current accounts. After the Second War, they had to raise the rates. During 1957, in the case of major scheduled banks the rates in Bombay on call, current, savings and six months and one year fixed deposits were 3 to $4\frac{11}{16}$, $\frac{1}{4}$, $2\frac{1}{2}$ and 2 to $4\frac{11}{16}$ per cent. respectively. The other banks had to pay slightly more. The variations were due to the changing nature of the season. The banks have now voluntarily entered into an agreement which has fixed the ceiling of 3 per cent. for all money, subject to 3 days' notice, and nil, 3 and 3-$4\frac{1}{2}$ per cent. for current, savings and fixed deposits respectively.

In the bigger towns, where stock exchange securities are available, a large portion of their advances is made against the hypothecation of these securities. In the interior, where such securities are not avaiable, advances are made against hypothecation of agricultural products, such as grain and cotton. As public warehouses do not exist in India, as in Western countries, the banks have to maintain their own godowns for this purpose, or to take possession of the godowns of the customers to whom advances are given. They also make advances to merchants against the security of piece-goods and other goods, and to factories against the security of their stock-in-trade, or some other tangible and marketable security. Further, they advance money against mortgages of properties, but this is usualy a small part of their total business, as properties are not easily saleable.[1]

The banks also make clean advances against personal security with two signatures to the promissory notes given by the borrowers. Promissory notes endorsed by shroffs or managing agents are quite acceptable to them. The hundi, which is even now used to a substantial extent by Indian traders, although its use has diminished in recent years, is also in reality two-name paper, as it is endorsed by indigenous bankers. However, in comparison with the volume of trade and the financial assistance needed by traders, that quantity of two-name paper acceptable to the banks is rather small, and the advances given by them against such security form a small part of their total advances.

1 See Thakur, *Organisation of Indian Banking*, pp. 66-7.

The most popular methods of lending are the overdraft account and cash credit account, by which an advance is made against a promissory note signed by the borrowers and secured by the hypothecation of bonds and shares in the former case and commodities in the latter case. These methods are beneficial to the banks as well as their customers. The latter pay interest only to the extent to which they use the credit from day to day, and they can pay back at any time any portion of the credit actually used, subject to a minimum interest clause, which means that they have to pay interest on a minimum sum, usually one-half of the maximum credit allowed to them. The banks also can curtail or withdraw the credit at any time.[1]

These banks transfer funds, by telegraphic transfer or demand draft, for their customers, from one place to another, making a minimum charge of 4 annas per cent., but charging less for large amounts. For this purpose, scheduled banks make use, without charge, of the Reserve Bank and, with charge, of the State Bank, with its numerous offices. The banks also do agency work and receive valuable articles, such as ornaments and securities, for safe custody. Many of them possess modern vaults for this purpose. The importance of this service is great in India, as its people hold a large part of their savings in the form of ornaments and precious metals.

They buy and sell shares and other stock exchange securities for the public, give it advice on investment, and thus promote the habit of investment, but their work and organization in this respect are much smaller and less systematic than those of banks in Western countries. They should develop this activity and should be allowed to become members of stock exchanges, because they can give more disinterested and sounder advice to their clients, as regards investment, especially in the shares of newly floated companies, than individual share-brokers.

Most of them do not do the work of executor and trustee. The biggest banks, however, have recently started this work. The banks do not rediscount their bills and do not do the business of bank accepances. Most of them also do not do any foreign exchange business, and take no part in the financing of India's foreign trade from the stage at which exports leave her ports or to the stage at which imports arrive at them. Half

1 See Central Committee Report, p. 381.

a dozen of them have begun this work recently, but owing to the special advantages possessed by the exchange banks, have not made much progress in this business. Thc small banks are generally loan offices which advance money to the professional and agricultural classes.

3. *Structure of their Assets and Liabilities.*—The quantities and character of resources limit the choice of business which banks can undertake. But they can also influence to some extent the volume and composition of their liabilities. Both in the long run are the reflection of the basic economic conditions of a country.

Structure of liabilities : Capital and reserve.—They serve as a guarantee fund to creditors and are useful for certain types of investment for which borrowed resources are not deemed so eligible. Their proportion to total liabilities depends upon bank policy, laws and amalgamations and inflation or deflation of currency. Amalgamation lowers the proportion because the bigger bank offers a smaller number of its shares in exchange for the issued capital of the smaller bank, on account of their having a higher market value. During inflationary or deflationary movements, capital and reserves may remain unchanged, while the volume of deposits alters rapidly. In a growing banking system, the growth of deposits influences the proportion most. This is true of the Big Five in India. The percentage of their capital and reserves to deposits was 18 in 1906, 12 in 1914, 10.6 in 1919, 9 in 1928 and 5.5 in 1948. In the case of the Imperial Bank, the percentage fell from 13.7 in 1938 to 4.2 in 1948, but rose to 5.18 in 1954. In the case of non-scheduled banks, the percentage has been higher, owing to their small capacity to attract deposits, but in their case also it fell from 25.2 in 1938 to 16.5 in 1948. In 1957, the percentages in the case of Indian scheduled and non-scheduled banks were 6.11 and 18.28 respectively. The desirable proportion can be decided only relatively to the special circumstances of each country and particularly to each phase of growth.

Deposit liabilities of banks.—As the use of cheques in India is limited to larger towns, the ½ proportion of demand deposits of the scheduled banks to total deposits is representative only of a small India, overshadowed by an immense India around, still possessing primitive monetary

habits. Moreover, this high proportion has been due to an arrest in the growth of fixed deposits resulting from the growing popularity of postal savings banks, cash certificates, life insurance and direct investment in shares and debentures, and from the decline in the long-term rate from 5½ p.c. in 1932 to 3½ in 1938. In a country like India, the infiltration of the masses into the banking system as evidenced by this high proportion exposes the system to all the irrational and tidal changes of moods which sway the mass of humanity. The proportion of places with banking facilities has altered very much in recent years in favour of smaller towns with less than 10,000 population bringing into the orbit of the banking system classes of smaller banking potentialities such as professional people, Government servants and even cultivators.

Structure of Assets.—The financial and economic structure of each country determines broadly the character of resources which banks attract and of their investments. Within this limit each bank and banking system have to reach a delicate balance between a maximum of profit and a maximum of liquidity and elasticity. The factors underlying the structure are themselves liable to large cyclical and secular changes amidst which continual watchfulness and adaptability are the only key to success in banking.

Loans and advances.—The proportion of loans and advances to total liabilities is not much higher in India than in other countries, in spite of the fact that returns on short-term investment are higher than on long-term investment. The large fluctuations that occur in the volume of loans and advances are due to the widening or narrowing of the gap between the short and long rates. The fact that the above proportion is not much higher in India suggests that the exploitation of the profitability of short-term investment is impeded either by the shortage of creditworthy borrowers or by the attractiveness of some other form of investment. The former is not peculiar to India. As regards the latter, the lender wishing to reap the high returns of the busy season has to run the risk of a heavy fall in his average profit, if the fall of rates in the slack season should turn out to be severer than expected. Investment in time loans, renewable according to circumstances, offers him a profitable alternative, whose steady returns are not an inadequate compensation for loss of liquidity. Moreover, in the absence

of mortgage institutions, many banks in India find it more profitable to give mortgage loans, especially if they have a high proportion of deposits fixed for one year or longer. Loans and advances may be further considered under three heads, *viz.* secured, unsecured and bad and doubtful.

The first head is the most important. Secured loans may be given against gold bullion, jewellery, Government securities, shares and debentures of joint-stock companies, commodities, such as piece-goods, cotton, jute, paddy, ground-nuts, coal etc., land and buildings and banks' own fixed deposits. The proportions in which the loans and advances are distributed against these different securities give a fair indication of the activities of a bank. Many smaller banks give a substantial portion of their loans and advances against gold bullion and jewellery, thereby showing that a good deal of their business is similar to that of a money-lender. The active Bullion Exchange in Bombay gives banks in that city good scope for loans against gold and silver bars, the total amount of such loans being large and the margins being small. As regards loans against commodities, the more a bank's business is banking business proper, the larger is the proportion of such loans to its total loans and advances. Experience since the First World War has shown the instability of the value of real estate as security. If the balance sheets of a bank show changes in the value of its "fixed assets" very frequently, they may be taken as indicating the trend of the banks' loans against real estate.

Unsecured loans and advances may consist of advances against trade bills, clean advances either supported by the guarantee of the borrowers only or supported by the guarantee of other persons also. The volume of trade bills generally gives a good indication of the liquidity of a bank, but their quality, depending upon the financial status of the parties to them, is an important consideration. As regards bad and doubtful debts, big banks, for reasons of prestige, rarely show them in their balance sheets. The smaller or less well-managed banks show them fully only when their difficulties come to be known to the public.

Loans and advances are given in the forms of cash credits, demand loans or overdrafts, and loans, which deserve attention from the viewpoint of reconciling liquidity with profitability. Within the limits imposed by the nature of business available in the area of their operations, banks influence the quality and

composition of their assets by means of different interest rates, margins, facilities and concessions regarding insurance of stocks. Cash credits involve certain drawbacks to banks, such as uncertainty regarding the extent to which funds lent may be used and the low rate of interest. But they involve certain advantages also, such as the personal security of men possessing high financial status and the short period of the arrangement, not exceeding six months. Overdrafts yield a higher rate of interest and are more suited to medium-sized lending. The security for them is usually Government securities, shares or personal credit. Loans vary more in size and are granted for a longer period, generally not exceeding a year, against Government securities, land and buildings, and shares. Cash credits and overdrafts are taken only for business purposes, but loans may be taken for non-business purposes also against land and building or ornaments.

Loans to money market.—They take three forms : (*a*) call loans to the bill market, (*b*) call and time loans to stock exchanges, (*c*) loans between the banks themselves.

Until recently, it was generally presumed that the creation of bills and a bill market in India was a prerequisite of a sound commercial and central banking system. The Reserve Bank, however, has not so far been able to take any effective steps for developing a bill market, except the limited bill market mentioned in section 2 of Chapter XI. This subject is examined in section 7 of the same chapter.

In recent years the volume of discounted bills has been small in India, that of the scheduled banks varying between 6 and 8 p.c. of their aggregate deposits. The same tendency is noticeable in several other countries. Intermediaries between producers and consumers are being eliminated as far as possible. The seller instead of drawing a bill on the buyer throws the burden of arranging the finance on him, and the buyer prefers to create an overdraft at his bank, which enables him to extinguish the debt by instalments and thus save in interest charges. The more frequent use of telegraphic transfers also narrows the basis for creation of bills. Although these forces are weak in India, they will become stronger gradually.

Treasury bills issued by Central and State Governments in which banks find an excellent lodgement for their temporary surpluses have grown in volume since the First World War.

While they offer all the advantages of liquidity, specific maturity etc., they do not require any grading or further endorsement to enhance their security. Hence, they do not need the elaborate machinery of a bill and discount market. Nevertheless, they do not yet form an appreciable part of the investment portfolio of banks in India. They occupy an important place in the investment portfolio of commercial banks in the West, as, next to cash and balances with banks, they rank as a highly liquid asset, yielding an adequate return and convertible into cash almost immediately. The liberal discount facilities given by the Reserve Bank and their current yield entitle them to more liberal support from the leading banks in India.

Loans from banks do not hold any important place in dealings on the stock exchanges in India which obtain the required funds mostly from private sources.

Iuvestments.—In India limited scope for investments in bills or loans to the money market makes the banks seek the more liquid and realizable securities, Government and non-Government, partly as a source of steady income and partly as a means to raise cash when required. Government securities, especially short-dated, are preferred as being less liable to depreciation. But the relative position of short and long rates and more particularly cyclical trends in rates and security values caused marked cyclical and secular changes in investments. Widening differentials between short and long rates and expectation of depreciation in the value of securities lead banks to reduce their investments in securities and vice versa. Thus the investments of the Big Five fell to 8 per cent. of the total assets in the early years of the First World War and rose to 45 per cent. by 1928. They were 33 per cent. in 1945 and 40 per cent. in 1955. At the end of 1960, the investments of Indian scheduled banks in Government securities were 25 per cent. of their total assets.

Thus the general belief that Indian banks invest a disproportionate part of their resources in Government securities ts not correct. On the contrary their investments show a commendable degree of elasticity and adaptability to circumsiances. The present high level of investments in Government securities is a feature not only of the banking system in India but also of that in several other countries. If the level is higher in India, it should be borne in mind that banks in other countries

have as a rule a second line of protection after cash in their call loans to the bill markets or stock exchanges.

The investments of scheduled banks now largely consist of short-dated and medium-dated securities.

Cash.—The cash ratio of banks as a whole is generally higher in India than in the U.S.A. or England, because call and short loans occupy an important place in the assets of the banks of the latter but not of the former. The ratio is in the neighbourhood of 10 per cent. in England and the U.S.A. and 15 per cent. in India. Among Indian banks themselves, cash ratios show remarkable disparities, partly due to policy and partly to the extent and character (large urban and industrial centres or smaller towns) of the regions that they serve.

Fixed assets.—These consist of buildings, in which banking offices are located, and the equipment of the offices. They are incidental to the business of banks and do not form an integral part of it. But sometimes they deserve attention. For instance, they may come into the possession of banks, without any design, because they were security for loans, which could not be repaid. Again, banks may undervalue them, with the object of creating a secret reserve. On the other hand, other banks may overvalue them in order to cancel their losses.

4. *Difficulties and Defects of Indian Joint-stock banks.*—It is seen from section 5 of Chapter I that the scope for the expansion of Indian joint-stock banking is still large. The absence of banking facilities must lead to the temporary locking up with individuals of large funds, which they have to spend later, but which they would make available for the development of credit facilities, especially during the busy season, if banking facilities are made available to them.

In spite of the large scope for expansion, the progress of Indian joint-stock banking has been slow, because it has had to face the following difficulties :—

(1) Indian banks have so far received little encouragement and support from Government, its officials and public bodies, and Municipal, Port Trust and University funds, funds of Courts of Wards, encumbered estates and minors' trusts and other trusts, and similar funds have not been kept with them.

(2) Many of them have not been able to do any foreign exchange business. In view of the great liquidity, safety and

profitability of genuine foreign exchange business, this inability has been a great handicap to them. Moreover, it has meant not only loss of a large income to India, but also considerable difficulties to Indians engaged in foreign trade.

(3) They have to face the competition of a number of exchange banks, which have appropriated a large part of the deposits and the profitable internal banking business of the important trade centres. The less profitable business in the smaller centres is left entirely to the Indian banks, but these find it difficult to handle it, if they cannot combine it adequately with the more profitable business, so as to average the lean with the fat.

(4) A substantial part of the trade and industry in India is still controlled by non-Indians who naturally prefer to deal with banks of their respective countries working in India.

(5) Even Indian firms and businessmen, who are in subordinate relations to non-Indian business firms, as brokers, agents, etc., or who have dealings with non-Indian shipping and insurance companies, are said to be induced to deal with the exchange banks in preference to the Indian banks.

(6) There was the competition of the Imperial Bank, which derived status and gain from the free use of Government balances, while these advantages were denied to the Indian banks. The competition, however, was not acute in recent years. There was no competition with regard to borrowing rates, and that with regard to lending rates proved advantageous to trade, as it reduced them. Further, the branches of the Bank provided trade with facilities for remittance and the easy flow of money from one centre to another. The Central Banking Committee summed up this situation thus : "On the one hand, they are looked upon as dangerous rivals by the indigenous bankers, and on the other, they frequently find themselves in opposition to the old established exchange banks and the powerful Imperial Bank of India. Placed in this position, therefore, they have been called the Cinderella of the Indian banking system, and have only been able to exist amidst bickerings, suspicions and cut-throat competition."[1]

(7) Numerous bank failures discouraged until recently investment in bank shares, which came to be regarded as speculative, and the placing or renewal with banks of the desposits of the public,

1 Report, p. 390.

which in many cases preferred to place them direct with merchants and industrialists. The failures also discouraged entrepreneurs from starting new banks.

(8) Some Hindu and Mohammedan laws and customs regarding succession to, and transfer of rights in, immoveable property make it unsafe for the banks to give loans on the security of such property. The development of credit is hampered, if a legal system does not enforce a prompt fulfilment of contracts, and the grant of credit at moderate charges is not practicable, if lenders have to provide insurance in their transactions against legal obstacles and the dangers of unjust treatment in the courts.

(9) Although, for short-term loans mortgages effected by a mere deposit of documents without any mortgage deeds or registration are the most convenient to businessmen and the banks, under the Transfer of Property Act, such equitable mortgages, as they are called, are valid only in the three Presidency towns and any other town which the Government of India may notify. This restriction has been imposed to prevent the exploitation of illiterate and unbusiness-like persons, but the banks are handicapped in their operations by the fact that equitable mortgages are invalid even in important commercial centres other than the four mentioned above.

(10) Although the Imperial Bank provided them with remittance facilities at the concessional rate of ½ anna per cent. for transfers of sums of Rs. 10,000 and over between their branches, as against its usual rate of 1 anna per cent. the Central Banking Committee found that even this charge was higher than that made in other countries, and that this prevented the banks from making the most of the financial resources of the country and lowering their charges. The Reserve Bank now provides its scheduled banks with remittance facilities free of charge for transfers of sums of Rs. 10,000 and over.

(11) Although in the legitimate expectation that Government securities would be promptly convertible into cash in a period of stress, the banks invested large sums in these securities, they were not able to borrow readily and fully from the Imperial Bank against such securities. There was also a prejudice against the rediscounting of bills by them with the Imperial Bank. Moreover, the latter either did not rediscount their bills freely,

or charged them the same rate that it charged its own customers for discounting their bills.

(12) Many banks in India work with inadequate capital and reserves and, therefore, suffer from many handicaps. They have to offer unduly high rates of interest to attract deposits, and to be able to pay them, they have often to undertake risky business. Moreover, to attract deposits, many of them, in spite of their small size, open branches not only in their provinces, but also in distant places in other provinces. When they extend their activities too far, they suffer from the difficulties which small institutions have to face, such as the competition of larger banks and inability to employ well-qualified staff or to spread their risks. Such banks are the most vulnerable points in India's banking system, and they become exposed as soon as India's credit system experiences the slightest shock.[1]

(13) During the seven or eight years prior to 1958, on account of very keen competition among Indian and Exchange Banks, all of them paid higher interest rates on deposits than before. Next to establishment charges, interest paid by banks on deposits was the most important cause of their increasing expenses during this period. During a part of each year, even some of the major scheduled banks paid 4½ per cent. on call money, 2½ per cent. on savings bank account and 4½ per cent. on deposits for one month, three months, six months or a year.

The most undesirable aspect of this competition was in respect of call money. Banks allowed their large customers to transfer funds from their current account to call and back to their current account when the customers needed the funds. Thus, every morning, during the considerable part of the year, large customers instructed their banks either in writing or on the telephone to transfer large funds from current accounts to call or from call to current accounts according to their own convenience and need and not those of the banks. During a considerable part of the year, banks paid 4 or 4½ per cent. interest and brokerage on call money. Formerly, this money used to remain in the current accounts of the customers in these banks. Hence, this new system meant that banks had to pay interest at or even above the Bank Rate on a large portion of

1 *Cf.* Report of the Fourth General Meeting of the Shareholders of the Reserve Bank of India, p. 38.

current account funds, which used to remain in current account, earning interest at $\frac{1}{4}$ per cent.

At the infomal suggestion of the Reserve Bank authorities, efforts were made during 1953-5 by the Imperial Bank of India, the Indian banks and the Exchange banks to arrive first at an all-India agreement to check this undesirable practice and to limit the rates of interest paid on different kinds of deposits, and then at a restricted agreement which would operate only in the cities of Bombay and Calcutta and only as regards call money. But, unfortunately, the attempts failed. At the end of 1958, the banks, feeling greatly the burden of the high rates and afraid that the Reserve Bank might intervene, voluntarily entered into an all-India agreement, which fixed ceilings on the rates. 14 Exchange Banks and 24 larger Indian Banks are members of the agreement and have abided by its promises.

(14) Another result of the very keen competition prevailing among banks was that, until 1960, in many cases, they did not charge adequate rates of interest on their advances. Each bank was afraid that its customers, particularly the bigger ones, would go to its competitors, if it were to raise the interest rates on its advances. Since 1960, however, they have raised the rates by 1 per cent.

(15) Most of the Indian banks have not yet built up adequate inner reserves in order to make their position sound. Every bank should build up an adequate inner reserve for providing for bad and doubtful debts, although it may be writing off its bad debts at the end of every year. The reason is that, even if it writes off its bad debts every year, all its remaining advances will not prove to be fully recoverable. The experience of bankers possessing many years' standing is that the proportion of bad debts is not less in respect of secured advances than in respect of clean advances. Even secured advances may become bad on account of political disturbances, frauds, legal defects in documents with parties, a sudden fall in prices of commodities and securities, etc.

Banks must build up sufficient inner reserves out of their profits to provide for such losses. If a bank meets such losses from its published reserves, it would suffer a loss of credit among depositors and the public and would run the risk of losing a portion of its deposits and even of a run upon it. Banks in all parts of the world build up inner reserves, so that their published

reserves may not be reduced by the occurrence of the contingencies mentioned above, and Indian banks must do the same in the interest of sound banking.

Banks should build up inner reserves also to provide for contingencies such as depreciation in investments, losses due to frauds by employees and customers etc. It seems that many Indian banks have not been able to build up appreciable inner reserves, as their profits have not been enough for the purpose.

(16) Since 1947 there have been prolonged disputes between Indian banks and their employees regarding emoluments paid by the former to the latter. Until 1949, such disputes were adjudicated upon in different States by different tribunals which gave different awards. This created great difficulties for banks which had branches in more than one State as regards transfer of their employees from branches located in one State to those in another. To overcome this difficulty, settlement of banking disputes was made a Central subject in 1949. But the mistake was made of providing for the settlement of such disputes for the banking industry as a whole in the entire country, instead of providing for the settlement unit-wise, which would have enabled the tribunals to take into consideration the capacity of each bank to pay its employees in giving their awards. The All-India Tribunals grouped the banks in three or four classes according to their deposits. But it has been found that the capacity of two banks belonging to the same class to pay their employees may be materially different.

(17) Some of the non-scheduled banks, numbering about 250 at present, are doing useful work and are being managed on sound lines, but find themselves unable to expand their activities, as they are little known and do not possess much credit.

Further, the mechanism of the working of these banks suffers from the following defects :—

(1) Investment in bills occupies an inadequate place in the structure of their assets. The development of credit facilities is hampered by the scarcity of trade bills and the absence of bank acceptances, so that the banks are compelled to invest a relatively large proportion of their funds in gilt-edged securities. The absence of bank acceptance credit is due to the popularity of the cash credit system, to the practical absence of documents of title, such as warehouse receipts, and railway receipts in a suitable

-form, to the high stamp duty on bills, and to the difficulty of introducing a form of bills acceptable in the whole country. The reasons for the scarcity of bills will be examined later.

(2) Whereas clean advances against the personal credit of the borrowers only, without tangible security, or a second signature, occupy a large place in the banking systems of Western countries, their use is very limited in India owing to the absence of the policy of 'one man, one bank' that prevails in the West, to the existence of the managing agency system, to the absence of commercial agencies life Seyd's in England and Dun's and Bradstreet's in the U.S.A. for supplying the banks with information regarding the financial status of the borrowers, and to the provision in the State Bank of India and Indian Companies Acts, laying down that the banks' advances must be shown separately as secured and unsecured in their balance sheets, coupled with the habit of the Indian public of regarding unsecured advances against properly appraised personal credit of borrowers as unsafe and unsound, whereas they are regarded as the best in the West.

In the opinion of the Foreign Experts associated with the Central Banking Committee, the unwillingness of Indian customers to supply their banks with full information regarding their resources and the position of their affairs is an important cause of the small amount of clean advances against the personal credit of the borrowers, but this opinion was not shared by the Central Committee.[1]

(3) All banks conduct their work in English, and their cheque-books, pass-books and paying-in-slips are printed in English. Only a few banks recognize cheques and signatures in the vernaculars. But the proportion of Indians who can read and write English is very small.

(4) The banks have done little to develop a technique suited to the conditions and resources of this country. They have been content to be rather ineffectual imitators of European models, and have not shown originality or initiative in chalking out new lines. They have not combined even that efficiency of the exchange banks and that simplicity and economy of the indigenous bankers, which would have enabled them to withstand the competition of both with equanimity. Many of them have adopted an expensive system of management on the

1 See Foreign Experts' Report, Central Committee Report, pp. 392 and 610.

standard set by the State Bank and the exchange banks. Yet their main weakness is the poor quality of their staff. No training suited to the needs of the smaller towns or the suburbs of big towns is given to them. "Premises of Indian banks are apt to present the appearance, sometimes of a holiday picnic and sometimes of the confusion and disorder of an Indian bazaar." Little attention has been paid to the planning and execution of bank organization. Little attempt is made to distinguish between profitable and unprofitable activities, and there is no cost accounting or specific investigations.

(5) The charge that Indian banks distribute too large a proportion of their net profits as dividends, in order to develop a false public confidence in themselves and to raise the value of their shares, is not true of the older and well-conducted banks. These, except in years of depression, have rarely distributed as dividends more than 60 per cent. of their net profits. The values of their shares have followed the course of stock exchange cycles and have not been unduly inflated. But new banks or banks which have not gained the confidence of the public, often declare dividends, although they have not secured adequate profits, because the public is apt to regard absence of dividends or low dividends as an indication of a doubtful future for a bank. It is difficult for them to give up this practice as long as the public fails to appreciate that low dividends or temporary absence of dividends can be the result of prudent management.[1]

(6) Some of the directors of the banks are not businessmen or financiers possessing sufficient ability and experience and, therefore, do not inspire much confidence.

(7) They have shown a lack of *esprit de corps*, and have suffered from mutual jealousies. The worst sinners in this respect have been those which have been the loudest in their condemnation of the exclusiveness of the exchange banks and the State Bank. In several cases, Indian banks seeking agents at centres, which have both Indian and exchange banks, have preferred the latter, and have shown a similar preference in selling T. T. on other Indian centres, or placing call money. Until very recently, they had no associations to consider matters of mutual interest and to decide upon lines of co-operation for improving their standard of banking, removing elements of weakness, and promoting the amalgamation of small with large banks. An

1 See Muranjan, *Modern Banking in India*, pp. 240-1.

important reason for their failure so far to secure a fair hearing for their grievances is this lack of co-operation and failure to present a united front.[1]

5. *Suggestions for removing defects.*—Unless these difficulties are tackled, many Indian joint-stock banks will not be able to make much progress. If the difficulties are removed, the banks will progress rapidly because many of them have shown enterprise, persistence and stamina. Most of these difficulties are capable of elimination, or considerable mitigation, in the following ways :—

(1) Government should lay down a policy of encouraging the growth of Indian joint-stock banking and should grant the banks concessions similar to those which have been granted to the co-operative banks. The former can promote the economic progress of the country as much as the latter. Moreover, they have been subjected to regulations and restrictions on public grounds, and in return for them they are entitled to concessions. The declaration of this policy by Government will improve the banking atmosphere in this country considerably, and if and when the banks are found securing large profits, the concessions can be reduced or withdrawn, or the profits can be subjected to higher taxation, or the banks can be made to render services to their customers more cheaply.

Thus, the banks should be given remittance concessions, and freedom from stamp duties and registration fees to the extent that they are enjoyed by the co-operative banks. Moreover, exemption from super-tax should be given for a limited period, if two small banks amalgamate, and any other obstacles that may be found in the way of such amalgamations, such as stamp duties or other taxation, should be removed. Further, Government should conduct its credit operations in ways that would minimise the difficulties of the banks in respect of a rise in the price of credit, or a depreciation in the value of their reserves.

(2) For removing unhealthy competition between these banks and the exchange banks, and substituting a spirit of co-operation, the Central Banking Committee and the Foreign Experts associated with it have suggested the formation of an All-India Bankers' Association, one of whose aims should be the laying down of principles and conventions calculated to

1 See the statement of the editors of Indian Finance, Central Committee Evidence, Vol. II, pp. 202-3

prevent unhealthy competition and overlapping among its members.[1] But the Committee, with the exception of Mr. Subedar and Mr. Sarkar, is not in favour of placing any restrictions on the branch activities of the exchange banks in India, in the larger interests of the country, beyond the restriction included in its recommendation that any bank wishing to open a new branch should be made to obtain for the purpose a licence from the Reserve Bank, which should ensure that the provisions of the law and other conditions specified in the licence are carried out by the bank.

Mr. Subedar, Mr. Sarkar, and a number of witnesses before the Committee have suggested that branches of the exchange banks should be confined to port towns only, that they should be made to close their existing branches in the interior, that they should not be permitted to receive deposits from Indians or companies registered in India, and that, to prevent them from obtaining controlling interests in Indian joint-stock banks, the foreign element in the shareholders and directors of the latter should be confined to a minority of 40 per cent. or less.

More moderate suggestions of other witnesses have been that the existing branches of the exchange banks in the interior should not be touched, but that they should not be allowed to open any new branches in the interior, and that they should be allowed to obtain only such sums by way of deposits from Indian people and companies as they are prepared to use in the country for the finance of her foreign trade. This subject will be discussed more fully in the next chapter.

(3) The Central Committee has recommended that to encourage Indian joint-stock banks to open new branches the Reserve Bank should place for the first five years with every new branch opened by an approved joint-stock bank at a centre which has no banking office, a deposit of such a sum on such conditions as it may consider necessary; that it should transfer funds on behalf of such banks between centres at which it has branches, free of cost as a national service, so as to help the equalization of interest rates throughout the country; that it should give these banks facilities for re-discounting their bills, at special rates below the bank rate whenever possible, and for securing financial accommodation on pro-notes against suitable

1 At present, the exchange banks and the Indian banks have their own separate Associations.

collateral; and that it should develop the use of trade bills in the place of the existing cash credit system. The Reserve Bank has given effect to the second and third of these recommendations. It is unfortunate that the first has not been included in the Reserve Bank Act. The last will require time to be carried out.

(4) The Central Committee and some of the Provincial Committees have recommended that the legal impediments to the development of credit presented by certain peculiarities of Hindu and Mohammedan laws which, as seen above, make it difficult for the banks to accept immovable property as a normal security, should be removed, and that the provisions of the Transfer of Property Act relating to equitable mortgages should be extended to a number of commercial centres throughout the country.[1]

(5) Banks should endeavour to increase their profits by reducing the rates of interest which they pay to their depositors, on the one hand, and by raising the rates of interest which they charge on their advances, on the other, and also by levying service charges, more freely than they have done hitherto, for the various services which they render to their customers. The All-India inter-bank agreement on maximum rates of interest on deposits formed at the end of 1958 has endured so far. If it fails later, on account of different money conditions in different parts of the country, it is most desirable that banks, with the assistance of the Reserve Bank, should arrive at regional agreements and adhere to them. With regard to charging higher rates of interest on advances, if an All-India agreement among banks is not regarded as practicable, banks, with the assistance of the Reserve Bank, should enter into regional agreements and adhere to them. Then they should endeavour to build up adequate inner reserves out of their increased profits.

(6) Banks and their employees must join hands to secure a settlement of their disputes, with the help of Government, which will last a considerable time and restore peace and cordial relations in the banking industry. At the same time, bank employees should be made to realize that their true interests in the long run depend upon the expansion of their banks and that the continuance of the disputes would harm not only the

1 See Bengal, Bombay and U. P. Committees Reports, pp. 191, 189 and 207 respectively.

interests of the shareholders of banks, but also their own long range interests as well as those of the depositors and the nation. They should also realize the necessity of working efficiently in return for a fair wage.

(7) In their own interest as well as in the interest of the expansion of banking in the country on sound lines, non-scheduled banks should link themselves to one or another of the scheduled banks.

The following are some suggestions for removing the defects in the mechanism of the working of the banks :—

(1) They should endeavour to develop the practice of 'one man, one bank,' and should launch upon a more progressive policy of giving clean advances against the personal credit of borrowers of undoubted means and character. Banks in Western countries have found such advances just as safe and satisfactory as two-name or collateral paper. With the increase in the number and the scale of production of business concerns, however, Indian banks find it very difficult to keep themselves in close touch with their borrowers and, as stated above, they are handicapped by the absence of special agencies for collecting the required information. Some of the banks have special departments for obtaining information regarding the financial standing of their clients, and sometimes they interchange this information. But in this respect, as in many others, fuller and freer co-operation among the banks is necessary.

The Indian Banks' Association, the Exchange Banks' Associations and the State Bank of India, should, therefore, arrange for a more systematic pooling of such information, and should build up an organization for the adequate collection of reliable information of this kind. This information can be obtained also from the balance-sheets or financial statements supplied by borrowers. Some witnesses before the Central Banking Committee and the Foreign Experts have expressed the opinion that borrowers in India are unwilling to explain fully their financial position to their banks. The Committee, however, has found that the charge is unfounded, and that the banks have generally no difficulty in obtaining financial statements from their customers before loans are given to them.[1]

(2) The banks should permit their clients free use of the vernaculars in the various fields of banking, including cheques,

1 Report, p. 384.

pass-books and paying-in-slips, and should not impose any special restrictions on their use, as such restrictions would defeat the very object of allowing the use, *viz.* the growth of the banking habit among the Indian people and an increase in the customers of the banks.[1]

(3) The banks can learn much from their competitors on both sides; they should combine the economical management of the indigenous bankers with the efficiency and modern methods of the exchange banks and the State Bank. They should also copy the trade union spirit of the exchange banks, if they want their grievances to be heard and redressed.

(4) If the banks find that the opening of new branches would not pay them owing to inadequate business, they should open in small centres, in the neighbourhood of bigger centres in which they have regular branches, sub-branches, which at first would be kept open for 2 or 3 days of the week, and managed by a small staff spared for these days by the neighbouring regular branches, and which may later develop into regular full-time branches. This system has done much to extend banking facilities in the rural areas of some Western countries, and the State Bank of India also has recently adopted it with benefit to itself and certain localities.

(5) The banks should pay more attention to the recruitment of a well-trained staff with a knowledge of local conditions, and should endeavour to secure the services of members of indigenous banking families.

(6) They should change their business hours in the mofussil during the busy season to suit the convenience of trade, wherevesr this change is desired by merchants.

(7) Organizations of shareholders in other parts of India on the lines of the Bombay Shareholders' Association will prove useful in inducing shareholders to take a more active interest in the affairs of the banks and in the election of their directors.

(8) It should be borne in mind that the elimination of impediments by law can only develop a healthy atomosphere for the expansion of banking, that Government can give only encouragement and guidance, and that an adequate expansion

1 Some banks allow the use of the vernaculars but subject to certain special restrictions. See Bombay Committee Report, p. 232.

of banking on sound lines must depend vitally on the initiative and enterpise of banking pioneers and entrepreneurs. The Central Banking Committee has, therefore, rightly stressed the need of carrying on a systematic propaganda for infusing the required optimism and initiative into the enterprising sections of the Indian public, leading to the needed quantitative as well as qualitative development of Indian banking.

6. *Disputes between Banks and their employees.*—As the cost of living increased considerably during the Second World War, banks gave a dearness allowance to their employees. The latter, however, felt that their total emoluments and amenities were inadequate and that their hours of work were too long. Hence, disputes arose between banks and their employees and in the middle of 1946 strike notices were served on several banks by their employees. The unrest was particularly acute in Bombay, Bengal and the U.P. The State Governments concerned intervened in these disputes and referred them to adjudication by tribunals appointed for the purpose. In 1947, Justice H. V. Divatia gave an award, which was made applicable to the offices of a number of banks in the cities of Bombay and Ahmedabad. Mr. R. Gupta and Mr. S. K. Sen gave awards which were made applicable to the offices of the Imperial Bank of India and the Central Bank of India respectively in Bengal. In the U.P., Mr. B. B. Singh gave an award which was made applicable to 40 banking companies operating in the U.P.

These different awards created great difficulties for banks, which had branches in more than one State, as regards transfer of their employees from branches located in one State to those in another. To overcome these difficulties, on the representations made by certain banks to have disputes settled by some central organization, the Central Government, in 1949, by legislation, took over the responsibility for resolving the disputes of banks having establishments in more than one State with their employees. The Central Government then appointed a tribunal presided over by Justice K. C. Sen, for the purpose of settling the disputes on an All-India basis. The award of the Sen Tribunal, given in 1950, was thought to be too burdensome by most banks. They, therefore, appealed against the award to the Supreme Court of India which, in 1951, declared the Sen Award void on account of some technical flaws in the constitution of the tribunal.

Thereupon, the Government of India passed a temporary Act freezing the scales of pay and rates of allowances awarded by the Sen Tribunal and appointed a Tribunal presided over by the late Justice S. Panchapagesa Sastry. The Award of the Sastry Tribunal, published in 1953, failed to satisfy the employees, who filed an appeal against the award before the Labour Appellate Tribunal of India. A Special Bench of this Tribunal gave its decision in 1954. As most banks thought that the burden imposed by this decison was beyond their capacity to bear, they appealed to the Government of India to set aside the decision. The Central Government, on a study of a rapid survey made by the Reserve Bank of India of the possible effect of the decision of the Labour Appellate Tribunal on the working of banks, concluded that it was inexpedient on public grounds to give effect to parts of the decision. Consequently, it modified the decision by an order made in August 1954. This was followed by the resignation of Mr. V. V. Giri, the Minister of Labour, a debate in Parliament in which many members criticised severely the Government Order and intense agitation by the bank employees.

Government then appointed a one-man Commission, consisting of the late Justice G. S. Rajadhyaksha and, on his death, of Justice P. B. Gajendragadkar, to help Government to assess more fully the effect of the bank awards by examining the question and making its recommendations. The Bank Award Commission's Report was published in August 1955 and in it the Commission recommended the restoration, in the case of Class A and Class B banks and those Class C banks which were declaring a dividend, of the scales of emoluments which had been recommended by the Appellate Tribunal and the retention of the scale of emoluments recommended by the Sastry Tribunal, for the remaining Class C banks and all Class D banks. Government accepted all the recommendations of the Bank Award Commission and Parliament gave effect to them by means of legislation. Although a majority of banks felt that the burden imposed upon them by this legislation was beyond their capacity to bear, they accepted it without protest, because they were anxious to restore harmonious relations with their employees.

Class A, B, C and D banks were those whose working funds amounted to Rs. 25 crores and more, to Rs. 7½ crores and more but below Rs. 25 crores, to Rs. 1 crore and more but below

Rs. 7½ crores and to less than Rs. 1 crore respectively. The scales of monthly wages of clerks in class A banks for areas 1, 2 and 3 were Rs. 88 rising upto Rs. 280, Rs. 77 rising upto 255 and Rs. 73 rising upto Rs. 245 respectively. Their dearness allowance for the three areas was minimum Rs. 50, 45 and 40 respectively and maximum first slab of Rs. 100, 50 per cent., second slab of Rs. 100, 40 per cent., thereafter 35 per cent., first slab of Rs. 100, 45 per cent., second slab of Rs. 100, 35 cent., thereafter 30 per cent. and first slab of Rs. 100, 40 per cent., second slab of Rs. 100, 30 per cent., thereafter 25 per cent. respectively. The scales of wages of clerks in the other classes of banks were a little lower, but they obtained the same dearness allowance as above. In addition, they received a house rent allowance ranging from Rs. 6 to Rs. 12 per month, and those clerks, who were graduates, holders of banking diplomas, comptists, stenographers, cashiers, supervisors, sub-accountants or head clerks received special allowances ranging from Rs. 8 to Rs. 50. Calcutta, Bombay, Madras, Delhi and Ahmedabad cities comprised area 1, other towns and cities having a population of one lakh and more comprised area 2 and all other places comprised area 3.

As the Industrial Disputes (Banking Companies) Decision Act 1955, which had given effect to the recommendations of the Bank Award Commission, expired on 31st March 1959, the Government of India appointed a National Industrial Tribunal, consisting of Mr. Justice K. T. Desai, a Judge of the Bombay High Court, in March, 1960 to adjudicate the disputes which had arisen between the banks and their employees. The Award of this Tribunal was published in July 1962 and was fully accepted by Government.

This Award has retained A, B and C classes of banks and merged the D class in the C class. It has merged a substantial part of the previous dearness allowance in the basic pay, which in the case of clerks in class A banks for areas 1, 2, and 3 is Rs. 140 rising to Rs. 405, Rs. 130 rising to Rs. 369 and Rs. 120 rising to Rs. 337 respectively. The scales of basic pay of clerks in B and C classes of banks are a little lower. But all of them obtain dearness allowance at 3 percent. of basic pay and special allowances for every change of 4 points in the quarterly average of the All-India Average Price Index (General) having 100 for 1949 as the base year. This means that if the index number is between 124 and 128 (as was the case in the middle of 1962) the dearness allowance is at the rate of Rs. 18 for Rs. 100 of pay. In addition, the clerks obtain a

house rent allowance ranging from Rs. 12 to Rs. 20 at Bombay, Calcutta and Delhi and from Rs. 9 to Rs. 15 at other large places and those who are graduates, holders of banking diplomas etc., as mentioned above, receive special allowances ranging from Rs. 10 to Rs.65.

7. *Need for more branches of existing banks as well as for new local banks.*—In a big country like India, the expansion of joint-stock banking should take place preferably by means of the establishment of new branches of the existing banks rather than the creation of more new banks, because large parent banks can distribute their risks among a number of branches, deal with local crises far more effectively than small local banks, and secure an increase in business and prestige. The large joint-stock banks, therefore, should try to follow the example set by the Imperial Bank in establishing a large number of branches. But the expansion need not be only on the basis of the establishment of more branches of large banks ; the establishment of small local banks also may be encouraged for the following reasons[1] :—

(1) There is still much local sentiment in India and local well-to-do people would in many cases feel far greater interest and confidence in local banks than in local branches of distant banks.

(2) Local banks would give local wealthy men much incentive to play a prominent role as directors, and so to make their resources available to the banks. Such men can be only depositors or shareholders of big banks operating in large areas. They would, therefore, have little stimulus to interest themselves directly in the working of such banks, and may prefer to engage themselves in trade, industry or indigenous banking, which would give them profits as well as social status.

(3) The concessions recommended above for joint-stock banks may induce some private bankers, individually or in groups, to form local joint-stock banks to secure the concessions, and yet to maintain their separate identity. But for these concessions, they would have little inducement to transform themselves into joint-stock banks, because the transformation would mean the payment of heavy registration fees, the keeping of accounts in certain prescribed forms, and unwelcome publicity.

1 See Assam Committee Report, p. 218

(4) The deposits which small banks secure are not such as the bigger banks would care to run after. Moreover, the financial needs which they meet are not such as the bigger banks would care to supply. The smaller banks occupy a middle position between the indigenous bankers and money-lenders on the one hand and the big modern banks, on the other. If the indigenous bankers and money-lenders are necessary for the economy of the country, the small banks deserve to be strengthened and improved as a channel leading the country from the older credit agencies and practices to modern banking. If the small banks are made to wind themselves up or to amalgamate with the bigger ones, as the result of discouragements it is doubtful whether the void that will be created by their disappearance can be filled at present by the bigger banks.

(5) Banking development in many Western countries has taken the form of the establishment of small local banks, which have gradually increased in number and size, and which have ultimately found strength and safety by the process of amalgamation as competition became severe. The establishment of small local banks in India will be facilitated, if large banks, and especially the Reserve Bank of India, provide them with the required stimulus and guidance in the spirit of a foster-mother, and a portion of the staff. Some of them may even find it useful to take up shares in the local banks, as this may help them to secure advantageous local connections.[1] The Nidhis of the Madras State and the loan offices of the West Bengal State can, thus, be transformed into sound and strong local banks under the stimulus of the concession mentioned above, the encouragement of public opinion, and the guidance of the larger banks and Government.

Finally, a substantial expansion of banking facilities can be effected by permitting in each State some of the central co-operative banks, which have suitable staff, to do ordinary commercial banking business, within safe limits and under definite instructions, at those places which do not have any branch of the Imperial Bank or a joint-stock bank. There are at present 505 central co-operative banks in the country. Many of them are lòcated at places which have no ordinary banking facilities.

1 *Cf.* Central Committee, Minority Report, p.125.

The Rural Banking Enquiry Committee was appointed by the Government of India in November, 1949, to recommend steps for the extension of banking facilities to rural areas.

The following are the more important conclusions and recommendations of the Committee :—

While it would be wrong to assume that large amounts of cash savings are available for collection through the extension of banking facilities to rural areas, it cannot also be categorically held that no possibilities of drawing rural savings into channels of investment exist at all. Further expansion of banking should, therefore, be on sound and cautious lines and the Imperial Bank and other commercial banks should be encouraged by Government to establish branches in taluka (or tehsil) towns, mandis or market towns and other towns of some commercial or industrial importance, so as to tap the savings already accumulated and being currently made by the relatively well-to-do rural classes, particularly in the more prosperous regions and to meet the need of such regions for advances. Co-operative banks can go deeper into rural areas than commercial banks, while small villages can be served by Co-operative Societies and Rural Post Office Savings Banks. The establishment of agricultural credit corporations or agricultural banks may be necessary in some regions, such as the former Indian States, but the establishment of an Agricultural Credit Corporation for the country as a whole is not opportune at present.

The Committee has not recommended the grant of direct cash subsidies to support rural branches of banks, because (1) subsidies will lead to charges of discrimination and favouritism and may adversely affect the credit of banks not selected; (2) subsidies tend to perpetuate themselves; (3) in banking, initial losses at new branches are not unusual; and (4) Government cannot afford to give substantial subsidies.

The Committee is not in favour of Government keeping interest-free deposits with banks, because (1) such an arrangement would be inconsistent with the scheme of the Reserve Bank Act, which requires the Central and State Governments to maintain all their balances with the Reserve Bank and also requires the scheduled banks to keep minimum balances with the Bank; (2) it would lead to the locking up of considerable

Government balances, which may prove embarrassing to Government; and (3) it would also be open to some of the other objections, which apply to the proposal for the grant of subsidies to banks.

The types of assistance to be offered to banks must, therefore, be in the nature of indirect stimuli available to all banks, such as a comprehensive rural development programme, improvement of the transport system, promotion of warehousing, subsidies and loans to banks for the construction of warehouses, permission to banks to keep their iron safes and chests for safe custody in the strong-rooms of treasuries and sub-treasuries, amendment of the existing legislation concerning money-lending, debt relief and allied matters, so as to place commercial banks on the same footing as the co-operative institutions, exemption of the offices of banks situated in towns having a population of less than 50,000 from the provisions of the Shops and Establishment Acts and the awards of Industrial Tribunals, liberalization of remittance facilities granted by the Reserve Bank and the Imperial Bank and the provision of adequate facilities throughout the country for the conversion and exchange of note and coin.

The Committee has recommended that, in addition to the special concessions and privileges which co-operative banks and societies enjoy at present, such as exemption from income-tax, stamp duties and registration fees, free audit and supervision by departmental agency, priority in the recovery of dues and facilities for their recovery through arbitration or departmental procedure and permission to inspect village records and obtain encumbrance certificates free of charge, they should be given the following special types of assistance :—

(1) The rates for postal remittances between co-operative institutions and the central financing agencies should be substantially lower than the normal rates ; (2) rules regarding the maximum up to which co-operative institutions may hold deposits in Post Office Savings Banks, the number of times they may operate on their accounts per week and the maximum they could withdraw per week, should be liberalised ; and (3) co-operative banks and societies should be approved for appointment as authorised agents for the sale of National Savings Certificates.

To enable co-operative banks to take increasing advantage of the financial accommodation available at concessional rates from the Reserve Bank and to obtain the advice and guidance of the latter more effectively, closer contact and liaison should be built up between them and the Reserve Bank. Further the scheme of the Government of Bombay for giving assistance to co-operative banks to enable them to extend their branches and to supply credit and other banking facilities to all credit-worthy agriculturists and the scheme of the Government of Madras for constituting a number of co-operative banks with limited liability in "major panchayat" villages, should be adopted by the Government of the other States, with such changes as may be necessary to suit local conditions.

In order to facilitate the implementation of the foregoing recommendations, the organization and working of treasuries and sub-treasuries should be strengthened and improved, the number of currency chests and branches of the State Bank should be increased and the Reserve Bank should establish at least one office in each major State.

The number of post offices doing savings bank work should be increased in rural areas to tap rural savings, they should use the regional languages to a large extent, their staff should be made to take more active interest in securing deposits, and the enforcement of rules regarding withdrawals and payments to heirs and dependents on the death of holders, should be made more elastic.

To provide greater opportunities for the rural people to come into contact with banking, non-bank treasuries should be converted into bank treasuries at as many centres as possible. But, although a change from the existing system, in which the State Bank functions as the sole agent of the Reserve Bank, may result in a reduction in the number of non-bank treasuries and also in some addition to branches of banks, it is not desirable to effect the change under the present conditions for the following reasons :—

(1) The agency which handles the receipts and payments on Government account has also the custody of the currency chests and small coin deposits and is responsible for providing facilities for exchange of notes and coin and remittance of funds to the Government departments, banks and the public. This combination of functions makes the selection of the Reserve

Bank's agents a matter of particular difficulty. It is not possible to separate the various functions so long as cash continues to play an important role in the day-to-day transactions in the country.

(2) The balances in the currency chests are so high that adequate cover in the form of Government securities cannot be povided by the majority of banks. The security has, therefore, to be found in the stability and solidity of the institution, and only first-rate banks of unimpeachable standing can be entrusted with the work.

(3) Government does not at present maintain any balances with the State Bank, which initially provides funds to meet Government disbursements, whenever they exceed receipts. Only banks having large cash and liquid resources of their own can assume a similar responsibility.

(4) A multiplicity of agents will result in misdirection of advices and entries and render the reconciliation of discrepancies in currency, remittance and Government transactions extremely difficult.

(5) As it is not possible to lay down objective criteria for the selection of agents of the Reserve Bank, a change in the present system will create a delicate and complicated problem of having to decide the competitive claims of different institutions.

(6) If a revision in the boundaries of States takes place later, the multi-agency system will require a re-definition of the regions allotted to different banks and this will introduce another complication.

8. *Recommendations of the Committee on 'Finance for the 'Private Sector' as affecting Commercial Banks.*—In October 1953, with the approval of the Government of India, the Reserve Bank appointed a Committee, under the Chairmanship of Mr. A. D. Shroff, known as the Shroff Committee, to examine how increased finance, particularly bank finance, could be made available to the private sector for its development. The Committee has made the following recommendations affecting commercial banks :—

(1) In adtition to the steps already taken by the Reserve Bank, there are other directions in which the Reserve Bank can give a lead and help commercial banks to undertake their new responsibilities with a greater degree of confidence. Although

it would not be advisable for the Reserve Bank to finance directly investments in private industry, the Bank can facilitate larger investments by commercial banks and other financial institutions by suitable adjustments in its lending and rediscounting practices.

(2) In creating the financial set-up, in which credit flows easily into preferred lines, the commercial banks and other financial institutions have a vital part to play. There are various adjustments in outlook and policy which commercial banks and other institutions can make without jeopardising their stability or restricting their field of operations.

(3) It is not desirable to encourage a tendency on the part of commercial banks to lean on the Reserve Bank for providing liquidity against long-term advances to industries which they may make on their own judgment and initiative.

(4) Banks should endeavour to increase their investments in the shares and debentures of first class industrial concerns, to make larger advances to approved parties against such shares and debentures and subscribe to a greater extent to the shares and bonds of specialised institutions like the Industrial Finance Corporation of India and the State Financial Corporations.

(5) The leading banks in India, in co-operation with insurance companies, should form a consortium or syndicate under the leadership of the State Bank of India for underwriting or investing in new shares and debentures of industrial companies.

(6) The Central and State Governments should prepare, in consultation with the Reserve Bank of India, an approved list of banks which may be authorised to receive deposits of local bodies or quasi-Government bodies and furnish guarantees and indemnities to Government departments on behalf of customers up to specified limits.

(7) Facilities under the bill market scheme should be made available to all scheduled banks with deposits of Rs. 1 crore or over. The individual minimum amount for bills should be reduced from Rs. 1 lakh to Rs. 50,000 and for parcels of bills from Rs. 25 lakhs to Rs. 10 lakhs. Limits for various banks should be fixed by the Reserve Bank in advance of the busy season and, for this purpose, the banks wishing to avail themselves of the scheme should apply to the Reserve Bank for limits in anticipation of the business they expect to handle in the season.

(8) On the analogy of the bill market scheme, the Reserve Bank should explore ways and means of increasing the resources of banks for the provision of medium-term finance by the Reserve Bank giving similar facilities under proper safeguards.

(9) The Reserve Bank should, in consultation with the Government of India, work out a detailed scheme of financial assistance to licenced scheduled banks opening branches in accordance with an expansion programme submitted by the banks and approved by the Reserve Bank. The assistance may take the form of a lump sum to cover part of the initial expenses of the branch and a commission in respect of deposits collected over a prescribed minimum. The Reserve Bank may also consider the desirability of not allowing more than one banking office to be opened in an undeveloped area for a limited period, say, up to 5 years.

(10) The State Governments should make adequate security arrangements for banks in mofussil areas, where considered necessary.

(11) Mobile banks should be encouraged and supported for developing the banking habit.

(12) The Reserve Bank should examine the question of making the drawing of cheques without sufficient funds a criminal offence. Banks should develop the practice of closing accounts on which cheques are so drawn.

(13) Banks should consider re-discounting of bills, drawn by traders and small industrialists and endorsed by the shroffs even in places where the banks do not have their offices, provided that the banks are satisfied regarding the standing of the parties.

(14) The Industrial Finance Corporation of India and the State Financial Corporations should give banks an opportunity to participate in the loans sanctioned by them. The Corporations should also examine the question of guaranteeing the long term loans advanced by scheduled banks or insurance companies.

9. *Structure of internal commercial finance as a whole.*—The parts played by different financial agencies in internal commercial finance, as a whole, are as follows :—

First, the finance of the movement of agricultural produce from the fields of the cultivators to the consumers, manufacturers or exporters. The cultivators generally do not require any finance to move their produce from their fields to the village

or the nearest town market. But most of them obtain advances from the village Banias for purposes of cultivation and other current requirements, including some of the necessaries of life, on personal security, accompanied by the condition that they would sell their produce, as soon as it is harvested, to the latter, without waiting for higher prices. The rate of interest charged on cash advances varies between 2 and 6 annas per rupee, *i.e.* 12½ and 37½ per cent. Sometimes they obtain the advances in kind and repay them on the *sawai* system, *i.e.* 1¼ times the quantity advanced. Some cultivators obtain advances from itinerant dealers or merchants in the local assembling markets at rates varying from 12 to 25 per cent., on condition that they would sell their produce to, or through, the latter. Some of the well-to-do cultivators, who can wait for some time after the harvest, obtain advances amounting to 60 to 75 per cent. of the value of their produce, on the security of the stock, at rates varying from 6 to 12 per cent., from the merchants in some assembling markets. In spite of the higher prices resulting from the war, the holding power of the majority of the cultivators is small. They are, therefore, as mentioned above, compelled to sell their produce, as soon as it is harvested, at prices lower than they should obtain. The holding power of the cultivators should be increased by making improved credit facilities available to them at a reasonable cost.

To a small extent, cultivators are financed by co-operative credit and loan and sale societies. The latter advance money on the security of the cultivators' crops and on the condition that the produce would be sold through them, or against the produce pledged to them, at rates varying from 6 to 12 per cent. Although cultivators can obtain finance from co-operative societies at a cost of only from ¼ to ½ of that payable to the banias or merchants, the societies have not made much progress in India and the banias thrive even in those villages, in which the societies exist. The reason seems to be that the majority of the cultivators are hardly creditworthy and little appears to have been done so far to make them creditworthy. Co-operative societies supply only the machinery of credit, but it cannot succeed, if creditworthiness does not exist. Strenuous and persistent efforts are, therefore, required to make the cultivators creditworthy by increasing the productivity of their lands and educating them to realize the necessity of improving the condi-

tions of their living and work, through the formation of multi-purpose co-operative societies in villages and by stabilizing the market prices of agricultural produce at a reasonable level. Moreover, the rates of interest charged by the village banias and their business practices, some of which are not honest, should be controlled by introducing a system of licenses for them.

The village banias and itinerant dealers, who finance the cultivators, in turn, are largely financed by kutcha arhatyas or merchants functioning in the local assembly markets, at rates varying from 9 to 12 per cent. and on condition that the former would sell the produce to the latter. The former also obtain advances from the latter on the security of produce stored by them with the latter. Kutcha arhatyas, working chiefly as commission agents for rural sellers in assembling markets are mainly financed by pucca arhatyas for very short periods at a rate of 7½ per cent. and have to pay due regard to the interest of their creditors while selling the produce. Pucca arhatyas, who operate chiefly as distributing agents, usually possess considerable financial resources, and many of them, in addition to dealing in agricultural and other products, do banking work. Their resources consist partly of their own funds and partly of deposits obtained from relations and friends at 6 per cent. They also obtain finance by drawing hundis which are discounted through shroffs, *i.e.* indigenous bankers of joint-stock banks.

Shroffs exist in all important markets and play an important role in financing the internal trade. They make advances against stocks of produce or on personal security at rates varying from 6 to 12 per cent. or discount hundis. Joint-stock banks make advances to pucca arhatyas amounting to 60 to 75 per cent. of the value of produce, which must be pledged to the banks and stored in godowns approved by, and under the locks of, the banks, at 6 per cent. interest. If the price of the produce falls, the borrowers must repay a sufficient amount to restore the margin and if the price rises they can borrow more. Banks also help the trade by remitting the necessary funds at a commission varying from ⅛ anna to 2 annas per cent. according to the condition of the supply of and demand for funds, and by discounting hundis or demand drafts.

The finance for the movement of produce from the assembling markets to the consuming and manufacturing centres and ports is provided by the merchants operating in the latter. If

the produce is sent on a consignment basis, *i.e.* for sale on commission, the commission agent advances up to 75 per cent. of the value of the produce and usually remits the amount by means of hundis. If the produce is purchased by exporters, 80 to 90 per cent. of its value is paid by their up-country agents on the basis of railway receipts. The remaining amount is paid after obtaining delivery of the produce.

The merchants financing the movement of agricultural produce depend for financial assistance chiefly upon shroffs, and only to a small extent on banks. Even in places in which the latter exist, the merchants often prefer dealing with the former, as the shroffs are more accessible and, being free from formalities, give advances more quickly and at rates which compare favourably with those charged by the banks. It is, therefore, necessary to strengthen the position of the shroffs by bringing them into direct relation with the Reserve Bank of India, and providing them with rediscounting facilities. The efforts that have been made by the Reserve Bank in this direction have not succeeded so far, mainly on account, of the Reserve Bank's insistence on the shroffs abandoning their non-banking activities. The Reserve Bank, therefore, has directed its attention to the development of an open bill market, in which first class bills, endorsed by shroffs, can be freely negotiated, by encouraging the construction of warehouses, so that bills backed by warehouse receipts could be brought into existence in large quantities.

Proceeding to the finance of the movement of manufactured goods from the factories to the distributing centres and the consumers, the manufacturers may deal directly, or through their managing agents, with wholesale dealers or large retail dealers operating in the distributing centres and the finance may be provided either by the dealers, or by joint-stock commercial banks or big shroffs. If the manufacturers know the dealers to be reliable, they despatch goods to the latter, draw bills of exchange of the value of the goods upon the latter, attach the railway receipts of the despatched goods to the bills and give the bills for collection to their banks located in the manufacturing centres. These banks send the bills to their branches located in the distributing centres, if existent, otherwise to correspondents there. The branches or correspondents either collect the amounts of the bills from the dealers on whom the bills are drawn (drawees), if the dealers can pay them imme-

diately, or retire the bills in the loan accounts of the dealers, under previous loaning arrangements and after obtaining reasonable margins, in case the latter are unable to pay the bills immediately. The charges of banks for collecting the bills vary between 1/32 and 1/8 per cent. from bank to bank, centre to centre, constituent to constituent and season to season. Well-established and trustworthy manufacturers, having established relations with banks, discount the bills drawn by them, with banks, instead of giving the bills to banks for collection. The charges of banks for discounting bills very between 1/16 and 1/4 per cent. on the same considerations as those mentioned above in the case of their charges for collecting bills. The discounting charges are higher than the collecting charges, because when bills are discounted, manufacturers receive the amounts of the bills less the discount immediately, whereas when the bills are collected, they receive the amounts less the collecting charges, only after the collection of the bills. If the dealers are not known to the manufacturers to be reliable, they have to arrange with the banks which know them, to open letters of credit in their favour and inform the manufacturers accordingly. The latter then despatch goods and draw bills upon the dealers under the letters of credit.

If it is desired to obtain the finance for the movement of goods from shroffs, the manufacturers draw hundis upon the dealers and discount them with shroffs, who usually sell them, through brokers, to parties wanting funds in the distributing centres, in which the dealers, on whom the hundis are drawn, operate. The dealers then pay the value of the hundis to the parties, which have purchased them from the shroffs operating in the manufacturing centres. The rates charged by the shroffs compare favourably with those charged by the joint-stock banks, and before the development of branch banking, the movement of a major portion of the manufactured goods was financed by them. In recent years, however, this financing has been increasingly handed over to the banks, as many of them have numerous branches and as, being well-organized institutions, banks can supply information regarding standing of the dealers to the manufacturers, while the shroffs are unable to do so.

10. *Keener competition among Banks since* 1960.—The competition among Indian banks for securing more deposits and more customers

has become much keener since 1960 than it had been ever before as managements of several banks have come into the hands of dynamic personalities, imbued with the ambition of raising the status of their banks and along with it their own status, in the banking system of the country. The managements of these banks are straining every nerve to push their banks up rapidly in the banking scale and the managements of other banks are obliged to follow suit, in order that their banks and they themselves may not be left behind in the competition.

The first form which this competition has taken is the establishment of new branches more rapidly than before. Unfortunately; most of these new branches have been established in places, which were already well-served by branches of other banks, and most of the places, which have no banking facilities, have been ignored, because the development of the saving and banking habits and securing of deposits in the latter places were thought to be difficult propositions. Consequently, competition among branches of banks in the former places has tended to become rather unhealthy since 1960.

It is true that the Banking Companies Act has laid down that no bank can open a new branch without a license from the Reserve Bank, which has to apply a number of criteria, one of which is whether the public interest would be served by the opening of the proposed branch. Until August 1962, the Reserve Bank issued linceses on an ad hoc basis, without evolving an overall policy of branch licensing, which would serve the public interest in a positive and active manner. The result was that the Reserve Bank sanctioned too many branches in certain places, although as many as 1400 smaller towns remained without any banking facilities altogether.

This attitude of the Reserve Bank became the subject of numerous complaints. There were also complaints that in issuing the licenses The Reserve Bank favoured some banks at the expense of others. In August 1962, therefore, the Reserve Bank issued a circular to all Indian scheduled banks stating that it desired to adopt a systematic and planned branch expansion scheme in the interests of orderly development of both the banks and the economy. It pointed out that although between the end of 1951 and 1961, the total number of offices of Indian banks rose from 4,055 to 5,040 (an increase of 555 and 1180 offices of the State Bank of India and other

Indian scheduled banks respectively, partly offset by a decline of 750 offices of non-scheduled banks), 1,400 out of 3,018 towns in the country, not to speak of semi-urban and rural areas, still remained without any banking facilities.

The Reserve Bank, therefore, asked the Indian scheduled banks to draw up and submit to it a programme of branch expansion for the next three years, and as a first step, to submit immediately a programme for the next twelve months, bearing in mind the need for the maintenance of adequate control by their head offices over their branches and the difficulty of doing so, if branches were opened too far away from the head offices. It also supplied a list of the 1,400 towns, which lacked banking facilities. The Reserve Bank circular, however, has not suggested any order of priorities for opening bank offices in the towns. It will not be easy for the Reserve Bank to prepare such a list of priorities and to sanction the branch expansion programmes of the different banks, within their respective spheres of influence, on the basis of such a list.

Another form which increasing competition among banks has taken is the widening of the range of their services to customers, especially in the provision of free remittance and collection facilities. A couple of banks took the lead in announcing the schemes and other had to follow. The schemes vary from bank to bank, but broadly cover free but limited number of remittances, in restricted amounts, by customers from their current or savings accounts to their accounts at other branches, free but restricted remittance facilities to non-customers also and free collection of cheques payable at their other branches. Further, many banks now open savings accounts in the names of minors. This shift of emphasis from paying higher rates of interest to rendering a wider range of services for attracting deposits is noteworthy.

A third form which increasing competition among banks has taken is the adoption first by a couple of banks and then by some other banks, of a personal loan scheme. Under the scheme, a bank gives loans, without taking any security, upto Rs. 5,000, to its customers, who are in regular employment or business, for purchasing durable consumer goods, such as a motor car, motor cycle, scooter, furniture, radio, record player, radiogram, air-conditioning machine, sewing machine, refrigerator, electric fan or other household appliances. The borrower repays the loan in 6, 12, 18 or 24 monthly instalments. The discount deducted initially from the loan varies from 5½ to 6 per cent.

Further, the outstanding advances made by Indian scheduled banks against the receipts issued by the Central and State Warehousing Corporations increased from Rs. 2 crores at the end of March 1960 to Rs. 9 crores at the end of March 1962, indicating the increasing use of warehousing facilities and of receipts as credit instruments in the marketing of agricultural products.

Finally, some banks have tried to attract big customers of other banks to themselves by offering to make advances to them at a lower rate of interest than that charged by the other banks.

It is now being realized that while competition among banks for improving the quality of the services, which they render to their customers, benefits the nation, unhealthy competition harms the banking system and the nation. Efforts are, therefore, now being made by the Indian Banks' Association and the Reserve Bank to devise measures for checking the unhealthy competition and they have been successful to some extent. The All-India Inter-Bank Agreement on Maximum Rates of Interest on Deposits has been acted upon by 38 banks, consisting of all the Exchange Banks, all the big and medium Indian banks and a couple of smaller banks since October 1958 and has prevented them from competing with one another in offering higher rates of interest on deposits. The Agreement on minimum Rates of Interest on advances has been entered into by them since November 1962 and prevents them from giving advances at a rate of interest lower than 6 per cent per annum. Efforts are now being made to form an agreement among them for service charges made to customers. The efforts which are being made by the Reserve Bank to systematise further expansion of branches of banks have been mentioned above.

11. *Recommendations of Indian Bankers' Seminar.*—A Seminar of Indian Bankers, held in Bombay in July 1962 under the auspices of the Indian Banks' Association, made the following recommendations :—

A. *Growth of deposits.*—(1) Commercial banks should take effective steps to finance progressively those activities which are now being financed mostly by the unorganized sector. (2) The Indian Banks' Association should carry on audio-visual and other types of centralized publicity campaign for educating the public about banking services and stimulating the saving and banking habit among it.

(3) Banks should consider introduction of new services, which have a direct bearing on the growth of deposits, such as prompt payment or teller system, drive-in-banks, night safe service, lock-box service, special checking accounts, personal money orders, Christmas-Diwali-Poojà clubs, gift cheques, insured savings banks accounts, property improvement and repair loans, insured educational loan plan, collection of salary and pension bills, executor and trustee facilities, perparation of income tax returns, issue and payment of shares and loans for joint-stock companies and unit trusts. (4) Steps should be taken to popularize payment of salaries and wages by cheques and credit transfers. (5) Banks should establish mobile branches, located in vans, as they have a great propaganda and publicity value and are also useful for nursing and tapping developing localities until they become ripe for having regular bank offices.

B. *Investments of Banks.*—(1) The Reserve Bank should issue treasury bills of the duration of 180 days in addition to that of 90 days, to enable banks to plan properly the investment of their surplus funds for the entire slack season. (2) The Reserve Bank should consider the feasibility of organising a money market which will provide ready marketability for Government securities, so that the investments of banks in them would really become liquid. (3) Banks should be permitted by legislation to include 5 per cent. of their investment in commercial bills and 5 per cent. of their call money, other than interbank call money, in their liquid assets which they are compelled to maintain against their liabilities.

C. *Facilities for the mobility of funds.*—(1) The Reserve Bank should make arrangements with its agents, namely the State Bank of India and its subsidiaries, for transfer of funds every day on behalf of a scheduled bank for credit into its account with the Reserve Bank. (2) Free remittance facilities every day should also be provided to scheduled banks, through the Reserve Bank, to any office of its agents. Similar facilities should be provided for transfer between the branches of the agents of the Reserve Bank. (3) The Reserve Bank should introduce tele-communication service between its offices in Bombay, Calcutta, Madras and Delhi.

D. *Advance-deposit ratio.*—A high advance-deposit ratio should not be looked upon with disfavour, if it occurs during the busy season, if the quality of the loans and advances made by banks is good and if they have maintained a satisfactory liquid position.

E. *Cooperation among banks.*—(1) The exchange of credit information between banks should be full, free and frank, on the model of reports received from overseas banks, with due legal and other safeguards. (2) There should be full exchange of information between banks regarding malpractices of particular customers, so as to place the other banks on their guard. (3) When more than one bank has been defrauded by the same customer, there should be full co-operation among the banks concerned to realize their dues. (4) Banks should adopt uniform practices in (*i*) enforcing submission of balance sheets and profit and loss accounts and income tax and wealth tax orders, where accommodation sought is in excess of Rs. 25,000 on a clean basis or Rs. 1 lakh on a secured basis, with a further right to banks to inspect the books of accounts of the borrowers and to demand a statement of outstanding advances from other banks, if any, (*ii*) enforcing margin effective control over pledged goods, display of godown signboards, submission of periodical stock statements and adequate insurance of stocks, and (*iii*) standardization of documents,

F. *Code of conduct among banks.*—With a view to ensuring safety and welfare of all the banks and maintaining the dignity of the banking profession in the country, a code of conduct should be evolved, which must be observed both in the spirit and the letter, particularly with reference to (*i*) the maintenance of minimum accepted standards in banking methods and practices, especially in lending operations, by adhering to traditional safeguards prescribed for different types of advances, (*ii*) the avoidance of unhealthy competition in opening branches, (*iii*) the avoidance of enticing trained personnel from other banks by offering them higher salaries, and (*iv*) the adoption of a convention, whereby the business of person, in regard to whom an enquiry has been made by a bank from his present bank,

is not solicited by the enquiring bank before the expiry of six months from the date of the enquiry.

G. *Organisation of a Credit Information Bureau.*—The Indian Banks' Association, jointly with the State Bank of India and Exchange Banks' Associations, should take steps to set up a Credit Information Bureau and should secure the necessary legal protection for the disclosure of information.

H. *Clearing Houses.*—(1) Clering houses should be established at places having five banking offices, if warranted by the volume of cheques. (2) The jurisdiction of the existing clearing houses in major cities should be enlarged so as to include all business localities in them. (3) Bank offices in each suburb of a large city should make arrangements to exchange cheques among themselves instead of clearing them through the City Clearing House. (4) The State Bank of India should accept Government securities instead of cash as security from members of the clearing houses and the amount of this security should be moderate.

I. *Service charges.*—An agreement for minimum service charges should be established among banks. This will benefit especially the smaller banks as the larger ones will not be able to take away customers from the former by lowering their service charges.

J. *Bill Market.*—The establishment of a Discount House and an Accepting House, as a prelude to the creation of a real Bill Market, should be considered.

K. *Financing foreign trade.*—(1) Having regard to the great increase in the demand for bank credit, in relation to the resources of banks, the procedure for borrowing by banks from the Reserve Bank, against export bills, under the Bill Market Scheme, should be simplified so that refinance becomes available to banks (*i*) on the aggregate amount of export bills outstanding at any time, (*ii*) on the single signature of the bank, and (*iii*) for a period upto 180 days. (2) Refinance required for medium and long-term export credits should be provided by the Refiance Corporation for Industry. (3) To provide more incentives, private commercial banks, which finance exports from the stage of manufacture to the point of shipment, should be given the due share in the resultant foreign exchange business,

even though such exports may subsequently be channelled through the State Trading Corporation.

L. *Mechanization of the work of banks.*—The Indian Banks' Association should evolve a common pattern of mechanization of the work of banks and the Government of India should take steps to encourage the manufacture in India of machines needed for the purpose and in the meanwhile to arrange immediately the import of these machines under the Development Loan Fund or any other appropriate agency, so as to enable the banks to tide over the present acute shortage of these machines in the country.

Some of the above recommendations may not be practicable at present, but they indicate some of the problems which banks in India have to face and solve in the immediate future.

CHAPTER VIII

FINANCING OF FOREIGN TRADE : EXCHANGE BANKS

1. *Their organization.*—Exchange banks are those which have their head offices outside India. In Western countries this phrase is used to denote "those banks that are specially concerned with financing the trade of India and China, which countries, not having a gold standard, have exchanges peculiarly liable to fluctuations". [1] Some Indian writers regard the phrase as misleading, because these banks do not restrict themselves to the finance of India's foreign trade, and play a large part in financing her internal trade, and because Indian joint-stock banks are free to do exchange business ; they have, therefore, proposed to call them foreign banks.[2]

The profits of banking in India have attracted the nationals of a number of countries having important trade relations with India, and there are at present 16 exchange banks, of which 6 have their head offices in England; 2 in the U.S.A., Pakistan and Japan; and one each in France, Holland, China and Hongkong.

1 Minty, *English Banking Methods* p. 44.

2 See Thakur, *Organisation of Indian Banking*, p. 70 and Central Committee Minority Report, p. 130.

They are divided into two groups, (1) banks doing a considerable portion of their business in India, *i.e.* having 25 per cent. or more of their deposits in India and (2) banks which are merely agencies in India of large banks doing a major portion of their business abroad, *i.e.* having less than 25 per cent. of their deposits in India.

The Chartered Bank, the National and Grindlays Bank, the Mercantile Bank of India and the Eastern Bank belong to the first group. Of the banks belonging to the second group, the American Express Company deals mostly with tourist traffic. The remaining banks are Lloyds Bank, which has taken over the business of Cox and Co., the Nederlandsche Handel-Maatschappij, popularly known as the Netherlands Trading Society, or the 'Trader', the National City Bank of New York, with which is amalgamated the International Banking Corporation, the Hongkong and Shanghai Bank, the Bank of China, Comptoir National d-Escompte De Paris, the British Bank of the Middle East, the Bank of Tokyo and the Mitsui Bank (Bombay branch re-opened in 1955). The Russo-Asiatic Bank and the Deutsche Asiatesche Bank closed their doors when the first War broke out. The Sumitomo Bank and the Imperial Bank of Persia closed their Indian branch at Bombay in 1932 and 1934 respectively. The P. and O. Bank was absorbed by the Chartered Bank in 1939. The Yokohama Specie Bank, the Mitsui Bank and the Bank of Taiwan were closed when Japan went to war with Great Britain in 1941. In 1944, the banking business of Thomas Cook and Son was taken over by Grindlays Bank. The Netherlands Indian Commercial Bank and the Banco National Ultramarino closed their Indian branches in 1950 and 1952 respectively. The business of the former has been taken over by the British Bank of the Middle East. In 1958, the National Bank of India and Grindlays Bank were amalgamated and formed the National and Grindlays Bank. The operations of Habib Bank and National Bank of Pakistan having their head offices in Pakistan, are small in India. The only other countries, which have had fairly important trade relations with India, but which have not been represented by their own banks in India, are Belgium and Italy. Recently, the British Exchange Banks have formed three groups, although they continue their operations separately. The Chartered Bank has taken over the Eastern Bank, the Hongkong Bank has

taken over the Mercantile Bank and the British Bank of the Middle East and the National and Grindlays Bank has taken over the Indian branches of Lloyds Bank.

2. *Operations of exchange banks.*—The main business of these banks is to finance the foreign trade of India. Until 1935 the Imperial Bank was prevented by law from dealing in bills of exchange payable outside India, and was allowed to make remittances outside India only for the *bona fide* personal needs of its customers. The Indian joint-stock banks are not prevented by law from engaging in this business, and a few of them now defunct, such as the Alliance Bank of Simla and the Tata Industrial Bank, did engage in it to a substantial extent, and the Central Bank of India has been carrying it on to a small extent.[1] Reently, other important scheduled banks have been doing a little foreign exchange business through their agents in Britain and the U.S.A. and a few of them have opened branches in London, Africa, the Middle East and the Far East after the Second World War. But the business was practically a monopoly of the exchange banks until Independence and is still largely in their hands for the following reasons. First, the Indian banks cannot withstand the competition of the far stronger exchange banks, which have far larger capital and reserves, and which obtain large funds from the London discount market at low rates. Secondly, the lack of branches in important foreign centres prevents them from engaging in arbitrage and direct exchange transactions. Finally, their limited financial resources have found more or less full employment in internal business.

They have found it difficult to establish branches at foreign centres owing to the following reasons :—

(1) They must have a large capital to command credit in the money markets of these centres.

(2) They must have large floating resources to allow a large turnover.

(3) The branches must be run at a loss for some time until they become self-supporting.

(4) They must have a dependable staff trained in international exchange work.

1 The Central Exchange Bank of India established by it in London in 1936 for this work had to be merged into Barclay's Bank, London, in 1938 but it opened a branch in London in 1950.

(5) They cannot expect to obtain substantial deposits and other business from the public, merchants and industrialists of these centres.

(6) They must face the hostility of the foreign banks.

(7) The existence of their head offices in India rather than in the worlds' financial centres, especially London, would handicap them in keeping themselves in close touch with the international monetary conditions, and securing import and export bills, and bills of collection.[1]

The exchange bank's work of financing India's foreign trade usually consists of two operations, *viz.* (1) the financing of the movement of goods from Indian ports to foreign ports and *vice versa,* and (2) the financing of it from, or to, Indian ports to or from, the distributing or collecting, centres in the interior of India.

To consider the mechanism of the first operation. When exporters from India sell goods to foreigners, *e.g.* in Great Britain, credit is generally opened with the London banks or finance houses and communicated to India through the exchange banks. Bills against such credit are drawn, usually at three months sight, and they are documentary. However, sight bills as well as those of more than 3 months' sight are sometimes drawn. Most of the bills are D.A. (documents on acceptance), only a small proportion being D. P. (documents on payment). The rate for a 3 months' bill is higher than that for a sight bill, because it includes interest for the duration of the bill at the rate prevailing at the centre on which the bill is drawn.

These bills are sent to London, and presented for acceptance, and after endorsement by the exchange banks, are generally discounted in the open market, thus enabling the exchange banks to receive in sterling what they paid in rupees in India. They may keep the bills till maturity, if they have ample funds, and if there is little immediate chance of making a profitable use of the funds. But they discount the bills, even at a high rate, if trade is active, or if money is scarce. Most of the bills between India and Europe, the U.S.A. and the Colonies are in sterling. Those between India and Japan are in yens, and those between India and China are in rupees.

The imports from Western countries are financed in two ways. The first method is generally used in connection with

1 See Central Committee Report, pp. 312-3

imports by Indians and those Europeans who do not have London houses of standing, and consists of Western exporters drawing 60 days' sight D.P. bills on importers in India and discounting them with the exchange banks. The exporters execute letters of request and hypothecation in favour of the exchange banks, which become holders for value of the bills. The importers frequently accept the bills and apply to the banks for the delivery of goods before payment, against trust receipts. The bills of lading and the other documents are then handed over to the importers, who obtain possession of the goods as trustees on behalf of the exchange banks. The former store the goods in godowns, and pay the bills when the goods are sold.

The other method is available to those European importers who have London houses of standing, and takes the form of London bank's acceptances of 'house' paper. According to this method, documentary bills are drawn by London exporting houses on the London offices of the exchange banks, which accept the bills and return them to the drawers, which discount them in the London money market. The accepting banks send the relative documents to their branches in India for the collection of the proceeds of the goods from the Indian offices of the exporting firms and remittances are sent to London at or before the maturity of the bills.

The bills under both the methods are drawn in sterling. On the former, interest is charged from the date of the drawing of the bills to the approximate date to the arrival of their proceeds in London, at 4 per cent. if the Bank of England rate is less than 4 per cent. and at 1 per cent. higher than the Bank of England rate if the latter is 4 per cent. or above. The latter bills are discounted in the London market at the prevailing rate of discount, which is always lower than the rate charged by the exchange banks on the former bills. European importers in India, who have London houses of standing, thus get an advantage over their Indian competitors. (It is also clear that in both exports and imports by Indians the adjustment of interest between producers and consumers is carried out in India, and that interest has to be taken into account in India in determining prices in both cases).

India has normally a favourable balance of trade, *i.e.* the total value of export bills is greater than that of import bills. The exchange banks finance the excess of the export bills, and enable

India to receive payment for her favourable balance, by means of the import of gold and silver bullion, the sale of sterling (payable in London) to the Reserve Bank of India, representing the Government of India in respect of the remittance operations necessary for the payment of the Home charges—a new method which has replaced the old method of the purchase of Council Bills and Telegraphic Transfers from the Secretary of State in London—transfer of Government rupee paper from London to India, and the sale of drafts and telegraphic transfers payable in London and other foreign centres to private clients in India.

The exchange banks also finance the movement of goods from, or to, Indian ports to, or from, the distributing, or collecting, centres in the interior of India, and for this purpose have 19 branches at 11 up-country centres. There has also been a movement in recent years among the exchange banks to obtain a footing in the interior by obtaining a controlling interest in Indian joint-stock banks through the purchase of their shares. For instance, the P. and O. Banking Corporation, soon after its establishment in 1920, purchased the Allahabad Bank with 40 branches in the interior, and the controlling interest in the former was obtained by the Chartered Bank in 1927. These branches are, therefore, practically exchange bank branches. With regard to trade between those up-country centres where exchange banks have branches, and foreign countries, merchants can get the banks to finance both the operations mentioned above in a single transaction. For instance, with regard to goods imported into Kanpur, the import bills drawn by the foreign exporters are forwarded to the Kanpur branch of an exchange bank, and their value is collected there by the branch from the importers, and is remitted outside India; and with regard to exports from Lahore, the Indian exporters can draw bills on the foreign purchasers under credits opened by the latter, and sell them direct to the Lahore branch of an exchange bank.

If the up-country centres have no branches of the exchange banks, the movement of goods between them and the Indian ports has to be financed by the importers and exporters through Indian joint-stock banks or other agencies, and the two operations in connection with the finance of foreign trade get definitely separated. The State Bank, Indian joint-stock banks and indigenous bankers finance the movement of produce

from the collecting centres to the ports for the purpose of export, by purchasing demand drafts drawn by the exporters' agents on the exporters' firms at the ports; and Indian joint-stock banks, shroffs and commission agents finance the movement of imported goods from the ports to the distributing centres. The exporters and importers, however, are said to prefer the financing of both the operations in a single transaction by an up-country branch of an exchange bank, as it is found cheaper.[1]

Besides financing foreign trade, the exchange banks do every kind of banking business. They compete with the State Bank and the Indian joint-stock banks by receiving deposits, making advances, negotiating bills, and doing agency business in India. For fixed deposits, they pay a slightly higher rate of interest than the State Bank, and a slightly lower rate than the Indian banks. On current accounts they paid the same rate as the Indian banks, *viz.*, 2 per cent. in the slack season and 2½ per cent. in the busy season, provided that the balances exceeded a certain minimum, while the State Bank did not pay interest on its current accounts. But they now pay ¼ per cent. on current accounts. The table on page 19 shows that they have succeeded in attracting very large deposits in India.

They finance internal trade in several up-country centres. The piece-goods trade in Delhi and Amritsar, the leather trade in Kanpur, and the jute trade in Bengal are financed by them to a large extent. They make much use of Marwari bankers, and make advances to them on the security of goods or produce, or discount their bills of exchange.

3. *Profits of exchange banks.*—The exchange banks are prosperous concerns, doing profitable business, and paying substantial dividends at the same rates from year to year in spite of the world-wide trade depression between the two World Wars.

The risk in their foreign exchange business has been largely removed by the establishment of the Sterling Exchange Standard, and it is removed still further by the process of covering, by which cautious bankers very nearly balance their sales and purchases of exchange. They have also gradually developed their internal business, which some of them find more profitable than their exchange business. The profits explain (1) the absorption of the Allahabad Bank by the P. and O. and the

1 See the Punjab Committee Report, p. 74.

absorption of the latter by the Chartered Bank as mentioned before ; (2) the purchase of Cox and King Companies by Lloyds Bank, one of the Big Five in England, which in addition to acting as army bankers and tourist agency as Cox and King Companies did, is competing with the State Bank and some Indian joint-stock banks at some commercial centres ; (3) the acquisition of a controlling interest in Grindlay and Company by the National Provincial Bank, another of the Big Five in England ; (4) the absorption of the International Banking Corporation and the American Express Company by the National City Bank of New York and by the Chase National Bank of New York respectively, two of the largest banks in the U.S.A. ; and (5) the absorption of the banking business of Thomas Cook and Son by Grindlay and Company and later the business of the latter by the National Bank.

All the exchange banks have established a strong position and a great reputation for themselves, and they are jealous of intruders. The view expressed by J. M. Keynes in 1913 that "Indian exchange banking is no business for speculative or enterprising outsiders and the large profits which it earns are protected by established and not easily assailable advantages,"[1] and that "it would be exceedingly difficult to start a new exchange bank except under the aegis of some important financial house already established in a strong position in India," still holds good to a large extent. In spite of the open door policy maintained by Government for three-quarters of a century, the number of exchange banks is still very small, *viz.* 16, and it is generally believed that the establishment of a new exchange bank would be difficult owing to the opposition of the existing banks.

4. *Complaints made against exchange banks and defects in their working.*—Indian witnesses before the Central and Provincial Banking Committees made the following complaints against the exchange banks, and the Committees themselves found some defects in their working.

(1) The exchange banks, until recently, were not subject to any legal restrictions in India, even to the statutory obligations to which the Indian joint-stock banks have been subject.[2] Their

1 Indian Currency and Finance, p. 208.

2 *Cf.* the Bank of India's statement, Central Committee Evidence, Vol. II, p. 32.

The following were the liabilities and assets in crores of Rupees, of the more inportamt exchange banks on 31st December 1961.

Name of Bank	Deposits	Due to other Banks	Other Liabilities	Profit or loss during the year	Total Liabilities or Assets	Cash in hand and at Banks	Money at Call and short Notice	Bills discounted and purchased	Loans and Advances	Investments	Premises	Other assets	No. of Offices in India
1. National and Grindlays Bank * ..	114.90	13.94	37.44	.61	166.29	9.96	.02	22.06	84.61	18.46	.54	30.64	32
2. Chartered Bank ..	59.34	2.05	9.25	.34	70.63	6.12	1.84	1.10	41.26	9.31	.64	10.36	10
3. First National City Bank ..	26.74	..	1.54	.72	28.28	.83	7.07	42.01	12.21	5.60	..	2.15	2
4. Mercantile Bank ..	18.97	8.92	3.57	.30	31.46	1.94	.04	3.79	19.31	3.00	.63	2.74	8
5. Hongkong and Shanghai Banking Corporation ..	8.16	2.20	3.48	.15	13.96	.45	..	1.39	8.60	1.51	.32	1.68	2

* Indian offices of the Lloyds Bank were amalgamated with this Bank in 1961

directors and shareholders are entirely foreign, and the control over them being thus exercised from abroad, their accounts need not be audited by recognized auditors. Until recently, they did not even publish in their balance-sheets separate information regarding their Indian business. The balance-sheets, supplied to Government once a year and published by the latter, were apt to be misleading owing to the lumping together of Indian and non-Indian business. The activities and affairs of the banks, therefore, remined a more or less closed book to the public and the Government of India. They obtain a large portion of their funds from Indians in the shape of deposits. But, until recently, the depositors were not protected by any regulations regarding the working of the banks, and they had no prior claim even on the assets of the banks in India, if any of the banks got involved into serious difficulties in another country owing to a crisis, fraud, or any other reason.

(2) These banks worked on the basis of inadequate cash reserves in India, during several years, and were therefore, a source of weakness to the money market in India during such periods. Keynes drew attention to this inadequacy in his *Indian Currency and Finance* in 1913, the banks did get into difficulties owing to it at the beginning of the First World War, and had to be helped. Getting wiser, they kept a larger proportion for a few years, but the proportion again dwindled afterwards. Since their profits have been substantial, they had no excuse for keeping low cash reserves. It was said that they had investments in Government securities and treasury bills, but no information was available regarding them.[1] The position of the cash balances is brought out by the table on page 219.

Since 1944 the precentages are supplied for the exchange banks as a whole and they are 29, 28, 26, 27, 10, 12, 11, 14, 9, 9, 9, 9, 9, 10, 8, 9, 9, and 9 at the end of 1944, 1945, 1946, 1947, 1948, 1949, 1950, 1951, 1952, 1953, 1954, 1955, 1956, 1957, 1958, 1959, 1960 and 1961 respectively.

(3) The exchange banks enjoyed a substantial monopoly of financing the foreign trade of India. While the monopoly was exercised largely with Indian funds obtained as deposits, it subjected Indians to a double loss—loss of banking as well as trading profits—and the loss increased with the growth of India's foreign trade.

1 See Central Committee Report, p. 550 and Minority Report, p. 179.

Year	Banks doing a considerable part of their business in India. Percentage of cash to deposit liabilities in India	Banks doing only a small part of their business in India. Percentage of cash to deposit liabilities in India
1900	23	..
1910	16	21
1913	19	17
1919	35	67
1920	30	58
1925	13	15
1926	14	17
1927	11	14
1928	11	11
1929	14	10
1930	13	8
1931	15	9
1932	12	15
1933	12	6
1934	10	13
1935	15	19
1936	15	11
1937	19	10
1938	13	7
1939	9	10
1940	16	22
1941	10	15
1942	11	13
1943	12	13

In addition to their own profits, the foreigners handling India's foreign trade enabled other non-Indians to earn several crores of rupees annually, in the shape of brokerage on goods sold and purchased, on exchange, on insurance, on freight obtained, and on other incidental transactions.

(i) The exchange banks were said to give poor references regarding Indian commercial houses to enquiries abroad and to give better references to foreign houses of a lower standing. The reason for this difference, as the representatives of the exchange banks had to admit, was that the managers of the banks, being foreigners, were not able to keep themselves in close touch with their Indian clients, on account of the lack of social contact, and had, therefore, to depend for information regarding their financial standing upon the reports of the subordinate members of their staff, or brokers, or shroffs.

(ii) While most of the foreign commercial houses are allowed to import goods on D.A. terms, Indian merchants can usually do so on D.P. terms only. This means that whereas the latter have to do business on a cash basis, the former enjoy extensive

credit. The representatives of the exchange banks have pointed out that the terms are settled, not by them, but by the exporters abroad, that they cannot grant D.A. terms without the orders of the exporters, and that their practice of releasing imported goods on trust receipts is more or less equivalent to D.A. terms.[1] In reply it has been stated that the reluctance of the overseas exporters to grant D. A. terms to the Indian importers is due to indifferent references supplied to the former regarding the latter by the banks, and that the practice of releasing imported goods on trust receipts is not equivalent to D. A. terms, as it involves higher charges on account of loans obtained on the trust receipts. Similarly, the complaint has been made that the banks generally do not discount the bills of Indian exporters without margins and securities, which in most cases they do not require at the time of discounting the bills of non-Indian exporters. The representatives of the exchange banks have explained this by stating that, in the case of the latter, arrangements exist at the other end, which make it safe for the banks to pay the full discounted value of the documentary bills. This may be so, but the fact remains that the Indian exporters are at a disadvantage.

(iii) Whereas in other countries, the banks engaged in the financing of export trade supply their customers with reliable and valuable information regarding foreign markets and prices prevailing there, the exchange banks have done little to supply any information of this kind to their customers. Foreign export houses working in India have connections abroad, and they obtain this information therefrom, so that it is the Indian exporters who are handicapped by the failure of the exchange banks to supply the information.

(iv) Most of the export and import trade is financed by means of sterling bills. With regard to the export trade, so long as credits can be opened in London, it is advantageous to the Indian exporters to draw bills on London and to avail themselves of the discount facilities provided by the largest money market in the world. With regard to the import trade, however, Indians do not get the benefit of the London discount market, and they are denied the benefit of the Indian market also, as their bills are drawn in sterling. Foreign import houses that have offices in London need not finance themselves by drawing bills on their Indian offices with documents attached

1. See their answers, Central Committee Evidence, Vol. III, pp. 336-7.

to them. They get the advantage of drawing bills on the London offices of the exchange banks, which accept them, and the bills are then discounted in the London market at the low rate generally current there. The shipping documents are sent to the Indian offices of the import houses which, thus, get an advantage in price over their Indian competitors. The latter are denied this advantage on the ground that they have no London offices. Their bills, being drawn in sterling, must be discounted with the exchange banks which charge a minimum rate of 4 per cent.[1] from the date of the drawing of the bills to the date of their payment plus the period of the remittance of the amount from India to London, although the rate prevailing in the Indian market may be lower.

(4) Another general complaint against the exchange banks was that they discouraged Indian enterprise in several directions, *e.g.* Indian brokers, banks, steamship companies and insurance companies. Complaints were made to the Central Banking Committee that Indian exporters were compelled by the exchange banks to insure their goods with foreign insurance companies. Special orders were then issued by the Exchange Banks' Association in London to the banks' offices in India for a more discreet treatment of Indian insurance companies. Moreover, several first-class Indian companies have come into existence. Hence, the position has substantially improved now.

(5) The exchange banks were said to have hampered the development of Indian joint-stock banks. In every country that has a fairly organized banking system, import bills are drawn in home currency, and after being accepted by the drawers are available for discount in the discount market of the importing country. As the financing of the foreign trade of India, however, is mostly in the hands of the exchange banks, the import bills, as mentioned before, are drawn in sterling in the case of imports from Europe and the U.S.A. and in yens in the case of those from Japan. These bills, of a very large value in the aggregate, are a very safe investment, as they are D. P. and have the signature of the drawers and the acceptance of the drawees on them. They are also a profitable investment, because the exchange banks earn interest on them at 4 per cent. at least for a period of 2 or 3 months. But being drawn in foreign currency, they are rendered useless, for the money market in

1 See Central Committee Report, p. 356.

India, are not available to the Indian banks for investments, and are the exclusive monopoly of the exchange banks. Had it not been for the strong position of the exchange banks, the change of the import bills from sterling and yens to rupees would have been effected long ago.

The Central Banking Committee expressed the opinion that the replacement of the cash credit system by bills in the finance of internal trade, which was at least 15 times as large as the foreign trade, would be far more effective than rupee import bills in supplying the Indian banks with a safe, adequate and liquid form of investment. But even in the finance of internal trade, the exchange banks are said to be offering serious competition to the Indian banks in recent years. Even Mr. MacDonald of the Imperial Bank admitted that the deposits obtained by the exchange banks were far in excess of their requirements for the finance of foreign trade. Moreover, the exchange banks took up new lines of business, which had been formerly in the hands of the Indian joint-stock banks only, and expanded on account of the restrictions on foreign trade which were necessitated by the Second War.

Further, while the exchange banks freely took call money from the Indian banks, they did not give it to them with the same freedom. Further, no Indian bank has been admitted a member of the Exchange Banks' Association, which is controlled largely by an inside council directed from London.

(6) The strong position of the exchange banks and their monopoly of the finance of India's foreign trade have been partly responsibile for splitting up the money market into two, European and Indian. Moreover, the easy access which they have to the London market means that the control of the Reserve Bank over them cannot be satisfactory or complete. Further, in no advanced country do foreign banks rank in importance above the indigenous joint-stock banks. It is true that in some of the Dominions, British banks play an important part. But their importance in India is far greater and there are no racial differences in the Dominions.

(7) Although the exchange banks have been working in India for nearly three-quarters of a century, until recently hardly any Indians were appointed in the superior grades of their service, except as cashiers or shroffs. The exception was unavoidable

as non-Indian officers could not be well acquainted with Indian customers and their financial standing. The only other posts in these banks, to which Indians could aspire, were clerical. In fact, no arrangement had been made by them for the selection of qualified Indians as apprentices for training and appointment in the grades of officers. They preferred importing their officers from abroad and paying them high salaries to the selection, training, and appointment of qualified Indians as officers with substantially lower salaries. Indian intellect was thus denied an opening to which it had every right, in view of the fact that the exchange banks obtain a large portion of their profits from Indian consumers, merchants, and depositors. Recently exchange banks have been appointing a few Indians as officers and sending them for special training to their London offices or to the special training centres which they maintain in England, but their pace in this respect has been slow.

The claim of the exchange banks, supported by the Foreign Experts, that they render cheap and efficient service to India, in a sphere of international finance requiring strong capital and connections, with funds obtained from abroad, mainly England, is also said to be untenable. In spite of the fact that they obtain large deposits in India at low rates and rediscount their bills in the London market also at lower rates, the exporters and importers in India have to pay higher rates for financial accommodation than their fellows in most Western countries. While the discount rate in the latter is lower than the banks rate, in India the exchange banks have kept it higher than the bank rate. The rediscounting in the London market, at low rates, of the export bills from India discounted on the basis of Indian money rates yields large profits to the exchange banks out of proportion to the risks that they run, and at the same time it provides profitable employment to the funds of the London market. The import bills are drawn in sterling and are discounted by the exchange banks, as seen before, at a minimum rate of 4 per cent. and this is one of the causes of the absence of a bill market in India. These import bills keep the importers in the hands and at the mercy of the exchange banks until the last moment.

5. *The question of licensing and restricting exchange banks.*— The Central Banking Committee was unanimous in the opinion that the policy of the open door to foreign banks in India should

be abandoned, that foreign banks should be regulated by the introdution of a system of licensing similar to that operating in various other countries such as Germany, Italy, Japan, and Canada, that no foreign bank should be permitted to establish a branch in India without a licence, and that the licensing authority should be the Reserve Bank of India. A licensing system was necessary partly to protect the interests of Indian depositors, partly to give the Reserve Bank the necessary control over all banks working in the country, and partly to secure reciprocal treatment in other countries for Indian banks.

A majority of the members of the Central Banking Committee recommended that in fairness to the exchange banks already operating in India, licences should be given to them freely, that every licence should be given for a definite period, and should be automatically renewed if the licensing authority was satisfied that the provisions of the Indian law applicable to such a bank and other conditions mentioned in the licence were duly carried out, and that these conditions should be that the exchange banks should supply to the Reserve Bank periodical reports showing separately their assets and liabilities in respect of their Indian and non-Indian business as laid down by the Reserve Bank, and that they would be subjected to restrictions on the basis of reciprocity.

The majority of the Committee also made the following suggestions for improving the working of the exchange banks in India and for removing the complaints that were made against them :—

(1) The exchange banks should examine the practicability of altering their existing procedure to the extent that they should accept the bills of Indian importers, instead of buying them, in the same way as that in which house paper of London export houses was accepted by them, so as to enable the bills to be discounted in the London market and to enable Indian importers to benefit from the cheap funds in that market.

(2) If Indian importers desired foreign exporters to draw on them in rupee bills, the exchange banks should help them in the matter. The Committee expressed the hope that when the average rate of discount in India was reduced by measures dealing with seasonal stringency in the Indian money market, this market would be able to offer as cheap facilities as foreign markets, and that Indian traders would make use of both kinds

of bills, rupee bills and bills in foreign currencies, according to their convenience.

(3) The exchange banks in consultation with the representatives of Indian insurance companies should arrive at an understanding with the latter, similar to that arrived at by the Imperial Bank, for the acceptance by the former of the policies of the latter, subject to the supply of certain information to the former regarding the operations of the latter.

(4) A local advisory board should be appointed at each branch of every exchange bank for giving advice regarding the grant of advances and cash credits. Although the advice given by such boards could be binding on the banks, the boards would help to establish a sympathetic contact between the foreign managers of these banks and their Indian clients, and to remove the complaint that the managers favoured their own nationals at the expense of their Indian customers.

(5) The Committee recommended to the exchange banks the working out of a scheme of Indian probationary assistants similar to that of the Imperial Bank and the appointment to responsible posts of such assistants as they found well-trained and efficient.

6. *Suggested terms of licence for exchange banks.*—Mr. Subedar, Mr. Sarkar and some Indian witnesses suggested certain terms of licence for the exchange banks on the basis that the drain of the profits of trade and banking from the country must be stopped, and that India must be allowed to develop her economic life and institutions to the best of her abilities. Mr. Subedar and Mr. Sarkar stated that many of the restrictions on the exchange banks proposed by them existed in the U.S.A., Japan, Canada, South Africa, Australia and several Continental countries, large and small.

(1) One restriction proposed as a term of the licences to be issued to the exchange banks was as regards deposits. The suggestions that were made in this respect were that the banks should be made to bring 50 per cent. of their working capital from abroad, that they should be allowed to receive deposits from Indians only to the extent of the funds that they needed for financing the foreign trade in Indian hands, that they should be allowed to receive Indian deposits only if they got themselves registered in India with rupee capital and Indian directorate

or that they should be prohibited from receiving deposits in India from Indian individuals, firms and companies.

The exchange banks were said to attract more deposits than were needed for the finance of India's foreign trade, and the surplus deposits obtained at low rates were said to be used by them to compete unfairly with the indigenous bankers and Indian banks in the finance of internal trade. The exchange banks were said to obtain these deposits not because they were safer, but because the depositors had hopes of obtaining better business facilities or better bank references for purposes of foreign trade, or fears of the withdrawal or curtailment of the existing facilities if they withdraw or reduce their deposits, and also because of their force of habit and the propaganda conducted by the banks against Indian institutions.

The prohibition would not cripple the resources of the exchange banks, because the banks would be free to obtain deposits from foreign individuals, firms and companies resident or operating in India, and the loss of the desposits of Indians could be made good by bringing funds from London and other international centres.

A majority of the Central Banking Committee and the Foreign Experts expressed the opinion that any restriction on the deposits of the exchange banks in India was neither necessary for the development of banking facilities in India, nor desirable in the wider interests of India.[1]

(2) Another restriction proposed as a term of the licence to be issued to the exchange banks was that they should be prohibited from having any branches in the country except in port towns. This proposal was made for the purpose of protecting Indians engaged in internal trade from which they were being driven away by foreign merchants who obtained special facilities from the exchange banks, and of protecting the Indian banks which were suffering from the competition of the exchange banks in the interior.

The majority of the Banking Committee, however, was opposed to this restriction on the ground that it might harm those engaged in handling the foreign trade of India.[2] In its opinion, the facility of direct connection with foreign exporters and importers was beneficial to Indian merchants. A group of this majority

1 Central Committee Report, pp. 337 and 647.

2 Central Committee Report, p. 340.

of the Committee, consisting of six members, in a minute of dissent, expressed the opinion that the unjustified encroachments of the exchange banks on the field of the finance of internal trade had assumed such proportion that no non-Indian bank should be allowed to have any branch up-country, *i.e.* at any place other than the main ports of India.

(3) It was proposed that no exchange bank should be permitted to obtain a controlling interest, directly or indirectly, in any Indian bank. To secure this, Indian banks must be made to keep separate registers of their Indian and non-Indian shareholders, and while their directors could freely allow transfers from the non-Indian register to the Indian one, they must carefully scrutinize every transfer *vice versa*, and must periodically issue a statement to the relevant authority that not more than 40 per cent. of the shares were held by foreigners.

(4) It was suggested that the licence should lay down that the whole staff, excepting the manager and one more official in each branch of an exchange bank, must be Indian, but that to prevent hardship, the licensing authority might temporarily relax this term in exceptional cases.[1]

(5) Copies of all returns, reports, balance-sheets and papers regarding their business in India sent by the licensed banks to their head offices abroad must be sent to the licensing authority, and all information regarding their Indian business must be supplied by them to the licensing authority in the form desired by it, the licensing authority having full discretion regarding the publication of this information.

(6) The admission of the branches of the licensed banks to clearing houses and their eligibility for rediscount and other facilities from the Reserve Bank should depend upon the discretion of the licensing authority.

7. *Suggestions for increasing the participation of Indians in the handling and finance of foreign trade.*—We may turn now to measures for increasing the participation of Indians in the handling and the finance of India's foreign trade. Even the majority of the Central Banking Committee admitted that India should not continue to depend on the facilities provided by the exchange banks for the financing of her foreign trade. The extent of a nation's participation in its foreign trade depends

1 *Cf.* Mr. Ramchandra Rau's statement, Central Committee Evidence, Vol. 11, p. 361.

vitally upon the banking facilities obtained by its traders. It is but natural that the exchange banks should give better facilities to their own nationals than to Indians. It has been mainly with this object that American, French, Japanese and Dutch banks have been established in India, even after a number of British banks had firmly established themselves in India.

Moreover, British banks all over the world have been very conservative in granting credit accommodation to all non-British customers. They have unduly kept down the period of the grant of credit, and have been unduly strict in the selection of merchants to whom they are prepared to grant credit. Germany and Japan, therefore, established their own banks for the grant of more liberal credit to their own merchants, and the wonderful growth of the foreign trade of both these countries brought about by their own merchants during the last half a century or so has been attributed to the liberal credit facilities provided by their own banks.[1] The Central Banking Committee and the Foreign Experts, therefore, suggested that well-established Indian joint-stock banks should open foreign connections for the benefit of their customers, as the German banks had done, so as to avoid the heavy cost of establishing branches at foreign centres.[2]

The Government of India and semi-Government institutions should encourage Indian Banks to participate increasingly in the finance of the country's foreign trade by carrying out all their foreign exchange business through these banks. That Indian Banks are capable of handling all this business efficiently and at competitive rates is shown by the following facts :—

About a quarter of a century ago, some Indian banks started doing foreign exchange business and, in spite of many obstacles, difficulties and hardships, they have succeeded in establishing themselves as institutions capable of handling foreign exchange business efficiently and at competitive rates. It is because of this fact that the big margin which was maintained by foreign exchange banks, between buying and selling rates of foreign exchange, has been narrowed down. It is also because of the same fact that the transit interest that used to be charged arbitrarily by the foreign exchange banks has been made reasonable and in keeping with the prevailing money market conditions.

1 *Cf.* Barrett-Whale, *Joint-Stock Banking in Germany*. p. 57, and Parker Willis and Backhart, *Foreign Banking Systems*. p. 822.

2 See Central Committee Report. p. 645.

The resources of Indian banks are large enough to cope with the foreign exchange transactions of the Government of India and semi-Government institutions in India. The comparison of the resources of Indian banks with the total world resources of foreign exchange banks, made by some persons in this connection, has no relevance to the issue, especially as the foreign exchange banks finance their foreign exchange business in India largely with funds obtained on deposit in India. The Indian deposits of Indian banks are far larger than the Indian deposits of foreign exchange banks and they are also increasing at a much quicker pace. Besides, foreign exchange business does not mean locking up funds for any great length of time. Hence, no large funds are needed for this business for any long period. It is the turnover of funds in this line of business that is of importance and not the total quantum of funds. The total amount of funds at the disposal of Indian Scheduled Banks is more than ample for the financing of the total exchange business of the country.

A review of the foreign exchange business transacted by Indian banks shows that their overall business in this line has been steadily increasing. The Indian banks, in addition to having agency arrangemens in all the important countries of the world, now have branches in Pakistan, Burma, Ceylon, Malaya, Thailand, Japan, Aden, British East Africa and London and can undertake any type of foreign exchange business at the same rates as those charged by the foreign exchange banks. In 1961, they had 53 and 48 branches in foreign countries, excluding Pakistan, and in Pakistan respectively and total liabilities there amounting to Rs. 106 crores. This indicates that Indian Banks are capable of handling the foreign exchange business of the Government of India and semi-Government institutions in India efficiently and at competitive rates.

Indian banks undertake the major part of the financing, in India, of goods which have been imported or which are to be exported, while the foreign exchange banks only finance the imports for a limited period after arrival and the exports for a limited period before shipment. The best interests of the national economy and development programme of the country require that as much foreign exchange business as possible should be entrusted to Indian banks, particularly because, soon

after the arrival of goods in India from abroad, it is almost exclusively the business of Indian banks to finance these goods until they are either installed, as in the case of machinery, or processed, as in the case of raw materials or semi-manufactured goods. It is through this very essential process, which arises after the foreign exchange financing of the transactions is over, that the Indian banks, and not foreign exchange banks, cater for the needs of the Indian economy. Hence, the Indian banks have a justifiable claim to obtain all the foreign exchange business of the Government of India and the semi-Government organizations.

If a through examination is made of the finance involved in this foreign exchange business and the rotation of such business, the capacity of Indian banks for handling this business will leave no room for doubt. The Government of India does a large amount of financial business abroad through its two Missions in the U.K. and the U.S.A., and this business is entrusted to British banks in London and to American banks in the U.S.A. While no Indian banks have branches in the U.S.A., four Indian banks have branches in London. Moreover, autonomous semi-Government bodies in India, such as the Damodar Valley Corporation, Sindri Fertiliser Factory etc., have a large amount of foreign exchange business. The handling of all these kinds of financial work can and should be given increasingly to Indian banks, which are in a position to handle them on competitive terms.

Finally, the Committee on Finance for the Private Sector, which was appointed by the Reserve Bank, expressed the opinion that Section 17(13) of the Reserve Bank of India Act should be amended to authorise the Reserve Bank to open accounts with Indian banks operating outside India in view of a number of Indian banks developing foreign exchange business through their branches abroad.

8. *Proposal for an Indian Exchange Bank, State or joint-stock.*—Further, the Committee recommended that, if the Reserve Bank was unable to make any satisfactory arrangement with the State Bank, or found that the latter was unable to take up substantial foreign exchange business within the agreed period, Government should establish an Indian Exchange Bank. The Committee was not in favour of establishing a new bank with Government assistance unless an endeavour was made to

achieve the same aim through the existing State Bank, the development of which had cost India much. The new bank should have a capital of Rs. 3 crores, which should be acquired in the course of 3 years, as far as possible in the form of subscription from Indian joint-stock banks ; the balance should be supplied by Government, which should gradually sell off its holding to the public. As long as Government owned more than one-half of the capital of the bank, it should be given the right to appoint a majority of the directors of the bank. The capital of Rs. 3 crores would not enable the bank to secure a material share of the foreign exchange business of India and it would not be able to obtain large deposits from the public, until it secured its confidence by means of careful management. For the first few years, therefore, it would have to depend much upon financial assistance obtained from the Reserve Bank by means of the rediscounting of its foreign bills. The bank should be given a privileged position by its appointment as an agent of the Reserve Bank for Government remittance operations subject to the control of the Reserve Bank, and the condition that the bank did not secure any profit from such operations.

9. *Proposal for 'joint' banks.*—It was suggested to the Central Banking Committee that the real and lasting solution of the problem of Indian foreign trade finance was the establishment of joint banks controlled by Indians and non-Indians belonging to the countries with which India traded, as equal partners. Foreign trade is between two parties, and it is opposed to the interests of both that one of them, either Indian or foreign, should dominate the finance of the trade. The trade as well as its finance need the co-operation of both the parties. The rupee capital of the joint banks would be supplied by Indians, their foreign capital by foreigners overseas, they would be under joint-supervision, and their profits would be divided among the partners.

Moreover, owing to the severe competition in internal and foreign trade, the Indian joint-stock banks and the exchange banks have been compelled to encroach on each other's preserves in the struggle for profit. To prevent this, it has been suggested that the Indian and exchange banks should evolve schemes of amalgamation, which would replace competition by co-opertion, and which would remove all suspicion of confiscation, domination, or absorption. Each bank should be given an equal

interest in the other, and the two should work together, not as agents or formal shareholders, but as one establishment managed for the benefit of both. Their expert staffs should be freely interchanged, their policy should be determined by full and frank consultations, and they should accept full rsponsibility for their mutual welfare.

The Central Banking Committee approved of this idea of 'joint' banks, as promoting co-operation and goodwill among nations trading with one another, but it expressed the opinion that the idea could not be enforced by means of legislation and was one primarily for the shareholders and directors of the banks to carry out.[1] Mr. Sarkar, however, considered the suggestion to be impracticable on the grounds that the exchange banks would not accept it except under compulsion and that Indians could not provide the large amount of capital that would be needed.[2]

In Mr. Subedar's opinion the best course for those British banks, which did the major portion of their total business in India, would be to get themselves registered in India, to convert their sterling capital into rupee capital, and to transfer their head offices from London to India. This would mean that, according to the restrictions proposed by him, the ownership of more than one-half of their capital would have to be transferred to Indians. This transformation would be in the interest of the British shareholders themselves, because the banks would be able not only to keep all their business and connections, but also to add to them by taking over the Indian deposits and a large part of the Indian business of those exchange banks which could not get themselves registered in India, and by getting the benefit of the concessions that would be given to the Indian joint-stock banks.

10. *Conclusion.*—Hardly any of the recommendations considered in this chapter have been carried out so far. It must, however, be admitted that the need for doing so is diminishing with the passage of each year, as the Exchange banks, realizing the altered political conditions, are becoming more accommodating and as Indian banks are becoming stronger. An important indication of this improvement is the formation of a composite Foreign Exchange Dealers Association of India,

1 Central Committee Report, p. 353.

2 See his Minute of Dissent, Central Committee Report, pp. 569-73.

consisting of all Exchange banks and those Indian banks, which are authorised by the Reserve Bank to deal in foreign exchange. This Association has been recognised by the Reserve Bank and has taken the place of the Exchange Banks' Association for the purpose of framing, subject to the approval of the Reserve Bank, the rules governing dealings in foreign exchange.

Further, the Exchange banks and the Indian banks are now co-operating with one another, through their Associations, in matters of common interest. The Associations have formed jointly, the Labour Secretariat of Banks in India for giving advice to their member banks on all matters, pertaining to labour. One matter of disagreement between the Exchange and Indian banks, however, is the desire of some of the former to expand their activities by establishing branches in the suburbs of port towns and in the larger towns in the interior of the country. The Indian banks are not in favour of allowing the Exchange banks to open branches anywhere in the country except in the business localities of the principal port towns. It seems that the Reserve Bank would find it difficult to impose any such restriction upon them, as some of them belong to countries upon which India is dependent for large amounts of loans and aid for her economic stability and development. The Government of India, however, is firm about preventing the officers of any Exchange bank from indulging in activities harmful to national interests. Recently, a few officers of an Exchange bank belonging to an Eastern country were found to be indulging in such activities. The Government of India, therefore, has empowered the Reserve Bank, by a suitable addition to the Banking Companies Act, to refuse or to cancel the license to a bank incorporated outside India, if it feels that it will not be in the interest of the public to allow the bank to operate or to continue to operate in India or if the bank belongs to a country which discriminates against Indian banks.

CHAPTER IX

FINANCING OF INDUSTRIES

1. *Financial difficulties of major industries.*—Industries need block capital to finance fixed assets, such as land, buildings, machinery and other durable and permanent apparatus, and working capital to finance floating assets *i.e.* for the purchase of

raw materials, their conversion into finished goods, the purchase of stores, expenses connected with the marketing of goods, financing outstandings concerning goods supplied, and the provision of funds for daily needs. Block capital is needed by new industries to make a start, and by old industries for expansion and replacement, and is more or less permanent. The working capital is partly long-term and partly short-term. The proportion between block and working capital in every industry depends upon its nature ; the more round-about the processes of production in an industry, the greater is the proportion of fixed to circulating capital in it.

The representatives of European Chambers of Commerce, the Exchange Banks' Association and the Imperial Bank of India, in their evidence before the Central Banking Committee, have expressed the opinion that major industries, established on sound lines and giving a fair promise of success, have no difficulty in obtaining the necessary finance for block or working capital from the existing sources of supply ; that every industrial concern should obtain its block capital by means of public or private subscriptions to its share or debentures ; that when it can supply a balance-sheet proving its soundness, the commercial banks should supply it with working capital on the security of its stock and other liquid assets ; and that it should not, and need not, look to Government patronage or financial assistance.

They have, however, admitted that their experience is confined mostly to the Presidency towns. If European industries in India have had no difficulty in obtaining all the finance that they need, this must be due to the close touch that they have maintained with the foreign banks in India. Indian witnesses before the Committee have expressed the opinion that even the major Indian industries have often to undergo difficulties in obtaining finance, and that the general position in this respect is unsatisfactory, and this is the general opinion in the country also.

Even as regards initial capital for promoting industries the available financial facilities have been very inadequate. Except from 1919 to 1922 and from 1943 to 1946, which were years of inflated currency and abnormal activity, the funds available for promoting industrial companies in the shape of private subscriptions to their share capital, have been inadequate.

The agricultural classes prefer to use their savings to obtain ornaments, purchase land, extend or improve agriculture, or give loans to neighbours. Even the middle classes who live in the smaller towns, including merchants and professional classes, prefer to invest their savings in loans to neighbours, landed property, or National Savings Certificates, which assure them a safe income free from the vicissitudes of industrial and commercial ventures. The reluctance of these classes to invest their savings in industrial securities is partly due to the fact that there are no banks or other financial agencies in the rural areas and the smaller towns to bring them into touch with such securities.

A large proportion of the people of the large towns even prefer to invest their savings in National Savings Certificates, partly on the principle of safety first, and partly because there are no organizations to facilitate the purchase and sale of industrial securities with the exception of a stock exchange in Madras, Bombay and Calcutta, and no institutions are ready to lend freely on the security of industrial shares, so that the shares often become almost as difficult to sell as immovable property, and investment in them becomes not materially different from locking-up of savings.

Since 1960, more funds are being made available for promoting industrial companies, in the shape of private subscriptions to their share capital on account of inflation of currency and greater industrial activity.

2. *Investment intermediaries.*—In Great Britain and the U.S.A., insurance companies, investment trusts, building societies and private business concerns invest large funds in industrial securities and help industries to obtain long-term capital by linking up savers with borrowers of capital in this way. Their operations, however, give little help to new concerns, because they generally purchase the securities of established concerns. In India, however, the part played by such investment intermediaries is small. Life Insurance Corporation of India and general insurance companies have invested only a small portion of their funds in industrial securities. Their holdings are mostly Government and semi-Government securities and the Insurance Act makes it obligatory on them to keep at least 55 per cent. of their assets in such securities. Proper building societies hardly exist in India and the holding

of industrial securities by private business concerns is small. There are half a dozen investment companies, but all of them cannot be regarded as investment trusts. Moreover, only three of then, *viz.* Birds Investment Company and New India Investment Corporation, both of Calcutta, and Industrial Investment Trust of Bombay, are fair sized. The other three are very small. Their total investment is about Rs. 2 crores and Government and semi-Government securities figure more prominently in it than industrial securities. Thus, in India institutions hold a small part of the industrial securities, most of which are held by individuals.

3. *Inadequate part of commercial banks in financing major Industries.*—Further, the following information shows that the part played by the existing commercial banks in the finance of Indian industries is very inadequate :—

(1) Although they can give valuable assistance to new concerns by using their own paid-up capital and reserve to purchase the debentures of the latter, so as to transfer them later to the investing public, they do not do so owing to a policy of conservatism. They do not even underwrite industrial shares or debentures to an appreciable extent, or lend money, to a substantial extent against these securities. The Imperial Bank, the largest commercial bank in the country, could not give loans to concerns for the purpose of block capital, because it was prevented by law from lending funds for more than six months, or on the security of industrial shares or immovable property. The other banks have followed the example of the Imperial Bank in this respect.[1] Now, however, the State Bank of India, has been authorized, subject to such instruction as may be issued by its Central Board, to invest its funds in debentures of companies with limited liability, registered in India or in such other country as the Central Government may approve.

(2) In giving loans for the purpose of working capital against the security of liquid assets, such as stocks, the State Bank keeps a margin of 30 per cent. or more, so that industrial concerns have to provide themselves with not only the entire fixed capital, but also a large proportion of the working capital, or to borrow it from indigenous banks at high rates of interest. The other banks have followed the lead of the State Bank in this respect also, and this attitude has imposed a hardship upon

1 *Cf.* Bengal Committee Report, pp. 121-2.

industries. The hardship is increased by the fact that the banks do not take into consideration the valuable fixed capital of industries, as general security for their loans. The banks can hardly be blamed for this as they are not much conversant with the technicalities involved in assessing the value of fixed assets such as plant and machinery.

(3) Contrary to the practice of many banks in Western countries,[1] banks in India do not attach much importance to the personal credit and honesty of the borrowers at the time of granting loans, and demand the full security of tangible and liquid assets.

(4) As trade and industry in India have to look to the same banks for finance, there is keen competition among them and in this competition industry fared worse until recently The situation has now improved and at present half of the total advances of commercial banks taken together are to industries.

(5) Banks in India do not get the help of technical experts to value the assets of concerns which apply for loans and to determine whether they are sound.

(6) The State Bank is compelled by law to insist on two signatures on the promissory notes obtained from the borrowing concerns, and the other banks often do the same as a measure of additional security. This means that the banks compel the borrowing concerns to supply guarantors, however, solvent they may be, and that over and above the specific security obtained from them, the banks become the general creditors of both the parties that have signed the promissory notes. The second signature is usually supplied by the managing agents of the borrowing concerns, and those concerns that have no managing agents find it difficult to obtain loans from the banks. This insistance of the banks has, therefore, lent considerable support to the defective managing agency system.

(7) Whatever industrial finance the banks supply mostly takes the form of demand or short-term loans out of short-term deposits received by them, and although they are willing to renew the loans from time to time so long as the borrowing enterprises continue to be solvent, they may not be able to do so, if an appreciable proportion of the deposits kept with them are withdrawn by their clients. This uncertainty regarding the renewal of the loans makes the position of the borrowing concerns difficult.

1 *Cf.* Walter Leaf, *Banking*, pp. 170-1.

(8) The interest charged on these loans by the banks has been fairly high namely 7 or 7½ per cent per annum. Higher rates have to be paid to obtain loans from smaller banks on mortgage or personal sureties. Loans obtained from indigenous bankers and merchants have proved still more costly, as a substantial commission has had to be paid to the intermediaries that arranged the loans.

(9) The cotton mills of Bombay and Ahmedabad have obtained a large part of their capital by means of deposits from the public. The deposits are generally obained for 6 or 12 months, and the interest paid on them varies between 4 and 6 per cent. according to the standing of the mills and their managing agents. The progress made by the cotton textile industry in these centres has been largely due to this system. The system however, has weakened considerably in recent years in Bombay owing to the counter-attraction of the interest obtainable from postal cash certificates and the inconvenience and loss sustained by a proportion of the depositors owing to the inability of a small number of mills to repay the deposits on the due dates, or at all.[1] The system is more vigorous in Ahmedabad. But in bad times in both of the centres these deposits may be withdrawn from sound as well as unsound mills, thereby increasing their difficulties at the very time when they need all resources to tide over a period of bad trade.

Although the system of keeping deposits with industrial concerns deserves commendation and maintenance as long as such concerns cannot get adequate finance from banks, it is primitive, unsuited to the conditions and needs of modern industry, and therefore doomed. Not only is a person who has made a small saving unable to judge the soundness of the concern with which he deposits it, but he also becomes an unsecured creditor, because the assets of the concern, on which he must depend for the repayment of his deposit, are handled by the directors of the concern as they like. The intervention of a bank between him and the concern would make his deposit much safer, because the bank with its organization would know the concerns to which to lend money and the time and period of lending it, and would be able to exercise some control over their assets. The intervention of a bank would benefit the borrowing concern also, because deposits kept with them are

1 See Minority Report, p. 329.

liable to be withdrawn at inconvenient moments, when they may find it very difficult to borrow in other quarters.

4. *Difficulties of issuing debentures.*—The Foreign Experts associated with the Central Banking Committee suggested that industrial concerns in India should progressively reduce their dependence upon the abovementioned methods of finance, and should rely more upon the issue of debentures, not only to make good the shortage of block capital for making a start and extending their operations, but also to obtain sufficient working capital. But the issue of debentures by industrial concerns in India is surrounded by the following difficulties[1] :—

(1) The issue of debentures reduces the credit of the issuing concerns with banks, as the debentureholders have to be given a prior lien on their assets. Unless, therefore, the issue has a very good chance of succeeding and supplying the issuing concern with all the funds that it is likely to need, no concern would risk the change. Concerns with a small amount of debentures would not only find it difficult to obtain financial accommodation from the banks on the former terms, but would also find it difficult to obtain that credit with regard to their raw materials, which at present plays a prominent part in their finance.

(2) The absence of issue houses to underwrite debenture issues makes the success of these issues difficult in India. Moreover, in Germany, the experience of which has principally led the Foreign Experts to make the above suggestion, a large portion of the issues of debentures is taken up in advance by the regular customers of banks, on the latter's advice which the customers accept, because they have full confidence in the soundness of this advice. It becomes easy then to dispose of the remainder of the issues to the ordinary investing public. This makes the underwriting of the issue easy and cheap. In India there is no established method by which the public can get sound advice and guidance in investing its savings. Of course, customers of banks can obtain some advice and assistance from them in this matter, but such advice and assistance are not sought and acted upon freely, especially as they are often given rather half-heartedly. There are some good firms of share-brokers, but it is difficult to rouse their enthusiasm in debentures issues, as the issues lack speculative attraction, and

1 See Central Committee Report, pp. 273-4 and Mr. Sarkar's Minute of Dissent, pp. 541-2.

cannot become the objects of frequent operations on the stock exchanges. Moreover, these brokers and exchanges are confined to the chief port towns, and mofussil investors find it difficult to get into touch with them.

(3) The heavy duty on the transfer of debentures and the fact that, owing to a fixed return, their market value cannot appreciate, militate against their popularity.

(4) Even the banks in India do not hold a large amount of debentures probably because they cannot always be sold readily. The banks do not always lend readily to their clients on the security of debentures. They do not give advances to their clients to help them to subscribe to issues of debentures.

The situation in respect of issue of debentures by companies has improved to some extent very recently and large well-established companies, enjoying a good reputation, are now able to issue debentures successfully, with the help of banks and large firms of brokers, which underwrite the issues.

5. *The managing agency system.*—On account of the above difficulties of industrial finance, a unique system, known as the managing agency system, has come to be developed in India, and has no counterpart in any other country. The system is the Indian substitute for a well-organized capital market and an industrial banking system of Western countries. The managing agents are individuals, or groups of individuals who, possessing strong financial resources, carry out the preliminary work of research and experiment precedent to the starting of new concerns, promote joint-stock companies, act as their financiers or guarantors, and generally manage their business. They are also often agents for buying raw materials for, and selling or disbtributing the products of, the concerns that they manage.

Their main functions can be grouped into the following three classes :—

(1) They serve as promoters of companies. They are rewarded for their risky preliminary operations, involving expenditure of money and exercise of technical and financial talent, by being entrusted with the management of the concerns in establishing which they take the initiative. A majority of the large industrial concerns in India has been established by them and is controlled by them.

(2) They take the place of underwriting houses of the West; by means of their financial reputation they secure the confidence

of the investing public and help new industrial companies to place their shares on the market and to mobilize the savings of the public for industrial uses.

(3) They assist industrial concerns to obtain working capital. The fixed capital is usually supplied by the shareholders. But the provision of this capital even is undertaken to a large extent by them, in place of the issue of debentures in the West. The working capital can be obtained by means of loans from the banks, or deposits from the public, or loans from the managing agents themselves. The difficulties of obtaining financial assistance from the banks have been already dealt with. Even when the banks do lend money, they are not prepared to lend it only on the security of the stocks in hand, or in process, or the mortgage of the fixed assets of the borrowing concerns; they demand, in addition, solvent and financially strong guarantors, and these happen in practice to be the managing agents.

The readiness of the public to deposit funds, and the rate at which they deposit them, depend entirely upon the financial standing and reputation of the managing agents of the companies concerned. Moreover, the managing agents often grant loans out of their own private resources to the concerns that they manage. Considering the importance of these functions, it is strange that some of the managing agents have no regular constitution and no systematic organization.

The system, however, has several grave defects, although many firms of managing agents are free from them. They are as follows :—

(1) The system has created a divorce between banking and industry, and has failed to secure a proper co-ordination between the total available savings of the public on the one hand, and the industrial schemes and organizing ability available in the country on the other. The dual existence of the system and the banks has retarded industrial progress. The agents tend to work in a groove, their outlook on industry becomes conservative, and they do not give sufficient attention to new industrial schemes. As they do not organize themselves into associations for active co-operation in the promotion of industry, they cannot command the services of technical and economic experts that are necessary for determining the soundness, practicability and profitableness of new industrial schemes. Moreover, as their financial resources are limited, they cannot promote an adequate

number of new concerns even in the protected and undoubtedly profitable branches of production.

In any case, they cannot have that close touch with the investing public, which banks can possess, so that they cannot float, or underwrite industrial issues readily, or to a considerable extent.

(2) The rights of the managing agents were heritable assets until 1937, so that it was inevitable that the management of industrial concerns should in the course of time pass into the hands of inefficient persons. These rights could also be sold and transferred without any reference to the shareholders.

(3) Not being directly interested in the fixed capital of the concerns that they manage, the managing agents may not properly protect the interests of the shareholders, and may even harm them. Some of them, in addition to managing their concerns, trade and speculate, and the resulting weakness in their financial position adversely affects the financial position of the concerns also, and causes banks to withdraw the cash credits granted to the concerns, although they are inherently sound. Some speculate on the stock exchanges in the shares of their own concerns and produce the same result. Some also take advantage of a rise of prices to boost their shares, and sell their own at top prices, leaving the new holders to bear the loss resulting from a fall in their prices soon afterwards. Some even run their own concerns into voluntary liquidation, after managing them at a loss, or without profit, for some time, form new companies, and take over the assets of the old ones at abnormally low prices. Some converted their loans to the concerns that they managed into debentures, so that the concerns passed into their hands as debenture-holders, and the shareholders practically lost the capital invested in the concerns, as their claims came after those of the debenture-holders.

(4) The management of the undertakings by the agents is apt to become inefficient, because they are often interested in giving employment to their relatives and friends in the undertakings and thus sacrifice talent and efficiency, and because they are tempted to purchase the raw materials and industrial accessories needed for the undertakings from the firms of their relatives and friends at prices higher than those ruling in the market, thereby raising unduly the cost of production.

(5) Until recently many managing agents received their remuneration in the form of a commission on purchases, production, or sales, or on two or all of these. This often tempted them to over-produce blindly without considering the demand. It also enabled them to appropriate an unduly large share of the profits, making the industry concerned less attractive to investors, and checking the flow of capital to it. It is, therefore, fortunate that this practice has been replaced by one of commission on net profit.

(6) The managing agency interest often represents a capitalized goodwill, and a new party may purchase it with the idea that it entitles him to profit from the undertaking as much as possible within the law.[1]

These defects of the managing agency system may jeopardize Indian industries in competition with their foreign rivals which are free from such defects. The Central Banking Committee and the Foreign Experts, therefore, expressed the opinion that attempts should be made to make industrial enterprises less dependent on this system, and to establish direct friendly relations between them and the banks.

To check the above defects of the system, the Indian Companies Amendment Act, 1936 has imposed the following restrictions upon its working :—

(1) No managing agent can, after the commencement of the Act, be appointed to hold office for more than 20 years at a time.

(2) A managing agent of a company appointed before the commencement of the Act cannot continue to hold office after the expiry of 20 years from the commencement of the Act unless reappointed thereto by a resolution at a general meeting.

(3) A company may remove a managing agent if he is convicted of an offence in relation to the affairs of the company punishable under the Indian Penal Code, unless the offending member is dismissed by the firm of managing agent within one month.

(4) A managing agent must vacate office if adjudged insolvent.

(5) A transfer of his office by a managing agent is void, unless one of the original partners continues in the firm, or unless the transfer is approved by the company at a general meeting.

1 *Cf.* Central Committee Minority Report, pp. 331-2.

(6) The appointment or removal of a managing agent, or any variation of his contract of management made after the commencement of the Act is invalid unless approved by the company concerned by a resolution at a general meeting.

(7) The remuneration of a managing agent appointed after the commencement of the Act must be a fixed percentage of the net annual profits of the company, with provision for a minimum payment in the case of absence or inadequacy of profits, together with an office allowance stated in the agreement of management.

(8) No company can give any loan of money to its managing agent or guarantee any loan made to him.

(9) Except with the consent of three-fourths of the directors of a company, its managing agent must not enter into any contract for the sale, purchase or supply of goods with the company.

(10) No company managed by a managing agent can give any loan to, or guarantee any loan made to, any other company managed by the same managing agent.

(11) No company other than an investment company can purchase shares or debentures of any other company managed by the same managing agent, unless the purchase has been approved by a unanimous decision of the board of directors of the purchasing company.

(12) No managing agent can exercise, in respect of the company that he is managing, a power to issue debentures or, except with the authority of the directors and within limits fixed by them, a power to invest the funds of the company.

(13) No managing agent can, on his own account, engage in any business which competes with the business carried on by a company under his management.

(14) The directors of a company, if any, appointed by its managing agent must not exceed in number one third of the whole number of directors.

(15) Every company managed by a managing agent must maintain a register which contains all details about the managing agent, and keep it open to inspection by the company's shareholders.

As the malpractices of several Managing Agents increased during the War and post-War years, the Indian Parliament has imposed the following further restrictions upon Managing Agents by incorporating them in the Companies Act 1956.

1. The Government of India is empowered to notify that companies engaged in specified classes of industry or business shall not have managing agents. Thereupon such companies cannot be managed by any managing agents after 15th August 1960.

2. No company acting as the managing agent of any other company can appoint a managing agent for itself and no company having a managing agent can be appointed as a managing agent of any other company.

3. In respect of any company, to which the above prohibitions do not apply, a managing agent cannot be appointed or re-appointed except by the company in general meeting and unless the approval of the Central Government has been obtained. The Central Government cannot accord its approval unless it is satisfied that it is not against the public interest to allow the company to have a managing agent and that the managing agent proposed is, in its opinion, a fit and proper person, to be appointed or re-appointed as such, and that the conditions of the managing agency agreement proposed are fair and reasonable.

4. No company can appoint a managing agent for the first time for a term exceeding 15 years or re-appoint one for a term exceeding 10 years at a time or re-appoint a managing agent for a fresh term when the existing term of the managing agent has two years or more to run.

5. A resolution of the company in general meeting and sanction of the Central Government are required for varying the terms of a managing agency agreement.

6. The term of office of an existing managing agent, if it does not expire earlier, must expire on 15th August 1960.

7. No person can be managing agent of more than 10 companies after 15th August 1960.

8. A company in general meeting can, by special resolution, remove its managing agent from office for gross negligence or mismanagement.

9. A transfer of his office by the managing agent of a company cannot take effect unless it is approved both by the company in general meeting and by the Central Government.

10. Changes in the constitution of a managing agency firm or corporation must be approved by the Central Government.

11. Remuneration of a managing agent ordinarily must not

exceed 11 per cent. of the net profits. Additional remuneration must be sanctioned by a special resolution of the company and must be approved by the Central Government as being in the public interest.

12. A managing agent is not entitled to office allowance, but is entitled to be reimbursed in respect of expenses.

13. No managing agent and no associate of his can receive any commission or other remuneration from the company in respect of sales in India of goods produced by the managed company. Nor can he receive any payment, except expenses, in respect of purchase of goods made on behalf of the company in India.

14. A company cannot be liable to pay its managing agent any compensation for the loss of his office when he resigns his office, vacates or is deemed to have vacated his office or is suspended or is deemed to have been suspended or removed from his office in pursuance of the above provisions.

15. The managing agent of a company must exercise his powers subject to the superintendence, control and direction of its board of directors and to the provisions of the memorandum and articles of the company.

16. Any provision in the memorandum or articles of a company or in any resolution passed in general meeting by, or by the board of directors of, the company prohibiting reconstruction or amalgamation of the company except on continuance of its managing agent must be regarded as void.

17. The managing agent of a company may, if so authorised by its articles, appoint not more than two directors where the total number of the directors exceeds five, and one director where the total number does not exceed five.

The wording of some of the sections of the Companies Act 1956 relating to managing agents has been changed by the Companies (Amendment) Act 1960, so as to tighten up some of the above restrictions

When the Companies Act 1956 came into force, over 5000 companies were managed by about 4000 managing agents. On account of the above restrictions, at the end of 1960, there were about 1400 companies managed by less than 1000 managing agents. Further, there has been a general reduction in the tenure and remuneration of the managing agents. It has now become an established practice to allow a tenure of 10 years in the case of

first appointment and of 5 years in the case of re-appointment. Even the 10 years' term is reduced in those cases in which the initial time required for bringing a company to the profit-earning stage is not long.

The general reduction in the amount of managing agency remuneration and other forms or remuneration from the managed companies, which before the commencement of the Companies Act was excessive in the case of certain companies, has been brought about in various ways like the introduction of a sliding scale of remuneration, a progressive reduction in the remuneration of managing agents and prevention of managing agents and their associates from having indirect earnings from companies managed by them.

It has not been possible for the Government to achieve better results in this regard because of the traditional practice of many banks and other institutions of asking for a guarantee from the managing agents for loans given to companies.

In respect of several other forms of indirect earning by the managing agents and their associates from the companies managed by them, for example, commission on sales and purchases and payments for various miscellaneous types of services said to be rendered by managing agents, the Act has provided for stringent control.

In suitable cases, additional restrictions have been also imposed on such earnings by the Government through appropriate administrative action at the time of according approval to the appointment or re-appointment of the managing agents. At the end of the first five years of the working of the Act, the managing agency system had adjusted itself to the new disciplines imposed by the statute and by the Government.

6. *Financial difficulties of medium, small and cottage industries.*— The financial needs of medium and small concerns, such as rice, flour, and oil mills, match, cigarette, glass, lac, and leather factories, cotton ginneries and presses, printing presses, chemical works, hosieries, and carpet and silk factories were examined by the various Provincial Banking Committees, and they have found that most of these concerns have great difficulties in obtaining the necessary finance, because the joint-stock banks are generally unwilling to provide them even working capital on account of the facts that their promoters who are mostly middle-class men, are unable to offer the security of approved names

or of stock that can be readily disposed of and that there is uncertainty about the marketability of their finished products at remunerative prices. The promoters cannot obtain sufficient capital from their friends and acquaintances. Consequently, they have to borrow funds at high rates of interest from money-lenders, indigenous bankers, and large dealers.

The situationi n this respect has improved recently and the advances of commercial banks to small industries amounted to Rs. 27 crores or about 2½ percent. of their total advances, as at the end of June 1961. Their advances to co-operative institutions amounted to Rs. 9 crores. With the object of encouraging them to increase further such advances, the Reserve Bank allowed them from the beginning of 1961 to borrow from it at the bank rate an amount equal to the increase in such advances, in addition to the amount which they were permitted to borrow under the existing facilities viz. half the average of statutory balances which they had to keep with the Reserve Bank.

The Provincial Committees have reported that the joint-stock banks do not provide any finance to cottage industries, such as handloom cotton, silk and wool weaving, gold and silver thread, brassware, bell metal, bidi and cheroot making, mat-making, gur-making, extraction of oil, rope-making, carpet-weaving, toy-making, dairy and poultry farming and wood-carving, which are to be found in different parts of India. The workers in these industries are, therefore, dependent upon money-lenders, who advance them materials at high prices, advance them cash for their bare subsistence, and in return receive their finished goods at low prices, thus making them suffer both ways.

7. *Suggestions for increasing the financial assistance of commercial banks to major industries.*—We may now consider what the commercial banks in India can do to provide financial assistance to major industries. Initial block capital for industrial undertakings should generally be obtained by means of private or public subscriptions. Block capital needed afterwards for improvement and expansion, and not obtained out of undistributed profits, should be secured by issuing debentures or more shares. But until conditions become favourable for placing such issues on the market, the commercial banks should give advances to undertakings for this purpose against sufficient security. The undertakings should obtain a minimum of working capital out of their initial capital, and extra working capital should

be supplied to them in the form of advances by the commercial banks, which should see that the undertakings keep a safe proportion between their own and borrowed capital.

Well-established and well-conducted commercial banks in India should follow the example of the German banks in helping industrial enterprises to issue shares and debentures. As investers may be unwilling to subscribe to the issues of industrial enterprises before they are in a full working condition, the German banks supply a large part of the initial capital to those enterprises with the promoters of which they are in permanent banking relations, and then help the promoters to place it afterwardss among the investing public in the form of shares or debentures. In order to diminish the risk and to increase the success of the issues, a number of German banks often form a pool called a Consortium, each bank undertaking to accept a portion of the issues. But this investment is not a long-period one, and is regarded by the banks only as a sound and liquid investment possessing excellent security. Moreover, these banks allow German enterprises to use their current account advances, not only for the purpose of obtaining working capital, but also for obtaining block capital for expansion, pending the issue of debentures or additional shares.

Many of the joint-stock banks in India are not strong and experienced enough at present for this work, but the larger and stronger banks should develop it gradually and cautiously as members of syndicates. If they do so, industrial enterprise in India will receive valuable assistance, especially as the growing connection of the banks with the issues of industrial shares and debentures will increase the confidence of the investing public in these issues.

Further, it is necessary for the banks to keep themselves in close touch with industries, so as to maintain an attitude of sympathy towards them, and to develop an atmosphere of mutual confidence for the benefit of both. This has been the keynote of the success of the association of the German banks with industries. Their managers serve on the boards of directors of the companies that they have financed. This close connection enables the companies to profit from the wide financial experience of the bank managers, and the banks to keep themselves in touch with the working of the companies, and to protect themselves from losses. Banks in India undertaking the finance of industries should follow this practice of the German banks

To achieve the same object, it is necessary that the whole banking business of an industrial enterprise needing finance from a bank should be entrusted to a single bank, and should not be distributed among a number of banks. Further, the banks should endeavour to follow a more liberal policy in accepting sound block capital as security for loans and also to supply a large part of the working capital required by industrial undertakings if adequate security is forthcoming.

Furthermore, the complaint has also been made that the banks in India are far less willing to lend to industrialists on personal security than banks in other countries. Of course, they cannot increase such loans indiscriminately, as even in other countries banks give loans on personal security only to big concerns enjoying a high financial reputation, but they should increase such loans gradually as the number of similar large concerns increases in India.[1] Finally, attention is invited to the recommendations of the Committee on Finance for the Private Sector given in section 7 of chapter VII of this book.

The unwillingness of commercial banks to make term advances against fixed assets of industries was probably justified under the British rule in India, when industries in the country were exposed to the full blast of foreign competition. But the banks should change this policy under the present attitude of the Indian Government of giving full protection to the industries in the home market. The development of all major industries at present is closely regulated by Government to meet the needs of the country within certain priorities. With the rapidly increasing demand for industrial products, industrial concerns in the organised sector, which are well-managed, are thriving and will continue to do so. Hence, grant of term advances to such concerns against their fixed assets, with proper safeguards and within reasonable limits, has now become a safe proposition for commercial banks.

According to the estimates of the need for and supply of funds for financing the fixed expenditure of industries in the private sector, under the Third Five Year Plan, there is a gap of Rs. 100 crores and commercial banks should try to meet it with their own funds and funds obtained from the Refinance Corporation. Their deposits and advances in July 1962, were Rs.2,000 and 1,400 crores respectively. Their deposits are expected to increase beyond Rs. 3,000 crores by the end of the Third Plan *i.e.* March,

1 See Central Committee Report, p. 229.

1966. It is felt that if banks make 5 percent of their total advances available in the form of term loans for the fixed expenditure of industries, with proper precautions and adequate safeguards, their liquidity and safety will not be affected adversely. But the difficulty is that banks have little experience of handling term loan proposals. In doing so, they have to satisfy themselves regarding the managerial ability of the entrepreneurs, the financial soundness of the projects, the economic position of the industries concerned and the technical feasibility of the projects. Unfortunately, they do not have the technical staff required for this purpose. Moreover, there is an acute shortage in the country of technical personnel of the required calibre and privaely owned technical consultant services are yet to be developed in this country. This difficulty as well as the shortage of finance may be dealt with by pooling together the knowledge, experience and finance of the banks and the specialised financial institutions. Pending the development of adequate specialised technical advisory services in the private sector, the Government of India may be requested to make the services of the technical men employed in the Development Wing of its Commerce and Industry Ministry available to the banks and the specialised institutions. Moreover, to enable smaller banks to participate in the financing of local industrial projects, they may be encouraged to sponser applications for joint participation by them and the larger banks in this financing. Further, the Refinance Corporation should make the grant of its re-finance facilities to banks more flexible. State Governments also, in the interests of the rapid industrialization of their respective areas, may be induced to agree to guarantee, upto a certain percentage, the losses of commercial banks arising out of their financing of local industrial projects.

8. *Organization and working of Central and State Industrial Corporations.*—The Central Banking Committee, all the Provincial Committees and most of their witnesses, however, agreed that the foregoing measures, although possessing much utility, could not deal adequately with the problem of industrial finance, and that it was necessary to establish an all-Indian industrial corporation to finance large industrial concerns and a number of provincial industrial concerns to finance medium sized industrial concerns, for longer periods and at lower rates.

The Industrial Finance Corporation of India was established in 1948 under an Act of the Central Legislature, for the purpose

of making medium and long-term credits more readily available to industrial concerns in India. The Corporation can do so only to public limited companies and co-operative societies.

The authorised capital of the Corporation is Rs. 10 crores. Of this, capital amounting to Rs. 5 crores in 10,000 shares, each of the paid-up value of Rs. 5,000 has been issued. The Government of India and the Reserve Bank of India have taken up 40 per cent. of the shares and scheduled banks, insurance companies, investment trusts and co-operative banks have taken up the remaining 60 per cent. of the shares. The shares can be transferred only to those authorities and institutions which could hold them in the first instance. The Corporation is effectively controlled by the Government through Government nominees on its Board and by means of the provision that the Government can issue directions to the Board on questions of policy, about which it is the sole judge. At the same time, it has secured the guidance and assistance of experienced businessmen, through its institutional shareholders, and also the capital resources of the latter. The shares of the Corporation have been guaranteed by the Government of India as to both repayment of principal and payment of annual dividend at 2¼ per cent., as fixed by Government. In the same way, debentures that have been issued by the Corporation for obtaining working capital, have been guaranteed by the Government in respect of the repayment of capital and the payment of interest at 3¼ per cent., as fixed by the Government. The total amount of debentures issued and outstanding and of the contingent liabilities of the Corporation in the form of guarantees given by it or underwriting agreements must not at any time exceed five times the amount of the paid-up share capital and reserve fund of the Corporation. Further, the Corporation can accept deposits from the pulbic repayable after not less than five years from the dates of obtaining them and subject to a maximum of Rs. 10 crores at any time. The Corporation can transact the following kinds of business :—

1. Guaranteeing, on such terms and conditions as may be agreed upon, loans raised by industrial concerns, which are repayable within 25 years and which are floated in the public market ;
2. Underwriting the issue of shares and debentures by industrial concerns ;
3. Receiving commission in respect of the above services ;

which it may have to take up in fulfilment of its underwriting liabilities, subject to disposing of such shares or debentures as early as possible and in any case within seven years; and

5. Granting loans or advances to, or subscribing to debentures of, industrial concerns, repayable within 25 years.

The Corporation, however, cannot grant accommodation under (1) and (5) above, unless it is secured by a sufficient pledge, mortgage, hypothecation or assignment of Government or other securities, shares, secured debentures, bullion, movable or immovable property or other tangible assets in the manner provided by the regulations. Further, it cannot grant such accommodation to a single industrial concern, amounting to more than Rs. 1 crore. Furthermore, it is prohibited from accepting deposits, except as provided above, and from subscribing direct to the shares of any limited company. The last restriction does not prevent it from functioning as an issue house, underwriting the issue of shares and debentures of companies and acquiring them in fulfilment of its underwriting liabilities. It can also function as a mortgage lending institution, guaranteeing and granting liened long-term loans.

In entering into any agreement with an industrial concern for granting accommodation to it, the Corporation has been empowered by the Act to impose such conditions as it may think necessary or expedient for protecting its own interests and securing that the accommodation granted by it is put to the best use by the industrial concern. Further, the Act has empowered the Corporation to make it one of the conditions that two directors will be appointed by it on the board of directors of the industrial concern to protect its own intersts. Where any industrial concern, which is under a liability to the Corporation under an agreement, makes any default in repayment or otherwise fails to comply with the terms of its agreement with the Corporation, the Corportion is empowered by the Act to take over the management of the concern as well as to sell and ralise the property pledged or mortgaged to it.

The general superintendence and direction of affairs and business of the Corporation have been entrusted to a Board of Directors, which, under a paid and full-time chairman, who is an official of the Government of India, and with the assistance of the General Manager, exercises all powers of the Corporation. The Board

has to act on business principles, with due regard to the interests of industry, commerce and the general public.

The Board must be guided by such instructions on questions of policy as may be given to it by the Central Government. If the Board fails to carry out the instructions, the Government can supersede the Board and appoint a new provincial Board until a properly constituted Board is set up. The Corporation may appoint one or more advisory committees to assist it.

The Board of Directors consists of :—

(1) 3 Directors nominated by the Central Government;

(2) 2 Directors nominated by the Central Board of the Reserve Bank ;

(3) 2 Directors elected by the scheduled banks which are shareholders of the Corporation;

(4) 2 Directors elected by the co-operative banks which are shareholders of the Corporation ; and

(5) 2 Directors elected by the shareholdes of the Corporation other than the Central Government, the Reserve Bank, the scheduled banks and co-operative banks.

The nominated directors hold office during the pleasure of the Central Government and the elected directors for 4 years. These directors can also be directors of industrial or other companies but cannot vote on any matter concerning an industrial concern in which they are directly or indirectly interested.

The Corporation has its Head Office in Delhi and offices in Bombay, Calcutta, Kanpur and Madras. It can establish offices or agencies in other places in India with the previous sanction of the Central Government.

Amendment of the Industral Finance Corporation Act in 1960 enlarged the activities of the Corporation as follows :—

(1) The Corporation can guarantee

(*a*) loans raised by industrial concerns from scheduled banks or State Co-operative banks ;

(*b*) deferred payments due from industrial concerns in connection with their purchase of capital goods both within and ouside India ;

(*c*) with the prior approval of the Central Government, loans raised from, and credit arrangements made with, any bank or financial institution in any country outside India by industrial concerns in foreign currency.

(2) The Corporation is empowered to subscribe directly to the stocks or shares of an industrial concern and also to convert, at its option, the loans granted or debentures subscribed to by it, into stocks or shares of the concern.

(3) The Corporation is empowered to give loans in excess of Rs. 1 crore with the approval of the Central Government.

The Corporation commenced its operations in June 1948. Its resources consist of Rs. 7 crores worth of paid-up capital, various reserves amounting to Rs. 1.69 crores, borrowings from the Central Government amounting to Rs. 13.25 crores, Rs. 9 crores provided by Government out of P. L. 480 funds and Rs. 22.24 crores worth of bonds issued at rates of interest varying from 3½ to 4½ per cent. per annum, placed with various institutions, the bonds being guaranteed by the Central Government as to the repayment of principal and payment of interest. It has obtained loans of U.S. dollars amounting to 30 millions from the Development Loan Fund of the U.S.A. Government, DM 15 million from West Germany, £2 million worth of yen credits and £ 10 million worth of French franc credits, for giving loans to industrial concerns, which apply for foreign exchange loans. It has not obtained any long-term deposits from the public.

Upto June 1960, the Corporation had underwritten new capital issued by companies amounting to Rs. 4.19 crores and guaranteed deferred payments in respect of goods valued at Rs. 20.25 crores imported by companies from abroad. Its largest activity, however, is the grant of advances against a first mortgage of the fixed assets of the borrowing companies, such as land, buildings, plant and machinery, and not against hypothecation of stocks, raw materials and finished goods.

The general policy of the Corporation at first was not to grant accommodation to concerns for their working capital, as the supply of such funds falls within the sphere of operation of commercial banks. But finding that the requirements of concerns regarding working capital have become far larger on account of high prices of raw materials, high wages etc., it has now relaxed its policy in this respect and lends, where necessary, reasonable amounts to applicants for their working capitals.

The rate of interest usually charged by the Corporation has been gradually raised from 5½ per cent. to 7½ per cent. per annum, with a rebate of ½ per cent., if the interest and the instalments of principal are paid on due dates. Hence the effective rate of

interest is 7 per cent. at present. The rate of interest charged by it on foreign currency loans, given out of its dollar credits is 8½ per cent. per annum with a rebate of ½ per cent. for prompt payment of interest and instalments.

The Corporation examines the industrial schemes submitted to it for loans in their technical and financial aspects and conducts field investigations and factory inspections. But it does not have its own staff of technical experts and has to obtain technical assistance from the Ministry of Commerce & Industry and the Council of Scientific Research of the Government of India. The Corporation examines the financial aspects of the scheme as carefully as the technical aspects. In considering applications, the Corporation applies the test of the profit-earning capacity and prospects of a company and not the ostensible value of its assets. Moreover, the Corporation demands the guarantee, joint and several, of the loans by the directors of the borrowing companies, appoints two directors in order to promote prudent management of the companies and stipulates that as long as the loans remain outstanding, the borrowing companies must not pay a dividend higher than 6 per cent. without its consent.

Although the Act allows the Corporation to grant loans for a period of 25 years, it has so far granted loans for a period not exceeding 15 years and ordinarily for 12 years only.

The Corporation carries out periodical inspections of companies which have obtained loans from it and also obtains periodical reports from them, so as to find out the progress made by them and the difficulties which they may encounter. These inspections and reports enable the Corporation to see from time to time how far the schedules for the implementation of the schemes are being adhered to by the companies and how far the companies have been succeeding in reducing costs and improving the quality of their products.

The loans sanctioned by the Corporation from its inception up to 30th June 1962 aggregated Rs. 130.2 crores. During these 14 years, a number of companies, on account of changes in the economic conditions in the country or changes in their plans or favourable changes in their financial position, did not avail themselves of the loans sanctioned to them. Moreover, some of the companies did not avail themselves of the full amount of the loans sanctioned. Finally, some other companies could not fulfil some of the important conditions and the loans sanctioned

were, therefore, not disbursed to them. *By the end of June 1961,* the Corporation had disbursed loans amounting to Rs. 58 crores, the amount outstanding being 49.6 crores. The industries to which loans were sanctioned were Textile Machinery, Mechanical and Electrical Engineering, Cotton, Woollen and Rayon Textiles, Chemicals, Cement, Ceramics and Glass, Oil Mills, Electric Power, Non-ferrous Metallurgical industry, Iron and Steel, Aluminium, Sugar, Mining, Paper and Automobile and Tractor.

In 1951, the Indian Parliament passed an Act for the establishment of State Industrial Finance Corporations for financing medium and small-scale industries. The Act applies to a State only when a notification of the Government of India to this effect is published at the request of the Government of the State concerned. Accordingly, such Corporations have been established in a number of States in the Indian Union and numbered 14 in 1961.

The authorised capital of a State Corporation must not be more than Rs. 1 crore and not less than Rs. 50 lakhs. The Government, Reserve Bank, scheduled banks, insurance companies, investment trusts, co-operative banks and other financial institutions are allowed to subscribe to their share capital. Members of the general public are allowed by the Central Government, in consultation with the State Governments concerned, to subscribe to not more than 25 per cent. of the share capital of the Corporations. Transferability of shares originally taken up by Government and financial institutions is restricted among themselves. Shares subscribed to by the public, however, are freely transferable. The shares are guaranteed by the State Governments concerned as to the repayment of the principal and the payment of annual dividend at such minimum rates as the State Governments, with the approval of the Central Government, fix by notification. Like the All-India Corporation, the State Corporations augment their resources by issuing debentures, which are guaranteed by the State Governments, but which must not exceed five times the amount of the share capital and reserve fund, and also by accepting deposits from the public, repayable after not less than 5 years and not exceeding the amount of the paid-up capital.

The Board of Directors consists of three Directors nominated by the State Government concerned, one by the Reserve Bank, one by the Board of the Central Industrial Finance Corporation,

two elected by all the shareholding financial institutions, one of whom must represent scheduled banks, one by the share-holding members of the public and one Managing Director appointed by the State Government in consultation with the Board. The Board thus has men possessing wide experience of industry and business on it and yet is subject to the control of the State Government and the Reserve Bank through the Directors nominated by them. The Bank has an Executive Committee consisting of the Managing Director as Chairman and three other Directors, all of whom are elected by the nominated Directors.

The Corporations are allowed to transact the following business :—

(1) Guaranteeing of loans raised by industrial concerns, which are repayable within 25 years and floated in the public market;
(2) The underwriting of the issues of shares and debentures of industrial concerns;
(3) The retention, as part of its assets, of any shares or debentures, which it may have to take up in fulfilment of its underwriting liabilities, provided that it disposes of them as early as practicable and in any case within seven years; and
(4) The granting of loans or advances to, or subscribing to debentures of, industrial concerns, repayable within 25 years.

They cannot give accommodation under 1 and 4 above unless it is sufficiently secured by pledge or mortgage of Government or other securities, bullion, or movable or immovable property.

The business of the Corporation thus is similar to that of the All-India Corporation. The difference, however, is that, while the latter can deal with public limited companies only, the former are allowed to deal with private companies, firms and individuals also. Smaller public companies, to whatever industries they belong, are financed by the State Corporations. The limit of their accommodation to a single application is placed at 10 per cent. of their paid-up capital or Rs. 10 lakhs, whichever amount is less.

Overlapping and duplication of business between the Central Corporation and the State Corporations are prevented by a working arrangement, by which no application that is dealt with by the Central Corporation is considered by the State

Corporations and *vice-versa.* Moreover, the Central and the State Corporations work in close co-operation with one another.

The State Corporations, like the Central Corporation, are prohibited from subscribing direct to the shares of any limited liability company and from accepting deposits for less than five years.

The total outstanding advances of all these Corporations taken together amounted to Rs. 24.2 crores in June 1962.

With regard to the above Corporations, the Committee on 'Finance for the Private Sector' has made the following recommendations:

(1) The Reserve Bank should treat shares and bonds of the Corporations as on a par with Government securities for making advances under Section 17 (4) (a) of the Reserve Bank of India Act.

(2) The Central Corporation should reduce the rate of interest on its loans to borrowing companies on condition that the latter compensate the former when they reach a profitable stage by repaying to the Corporation the difference between the reduced rate and the Corporation's usual lending rate.

(3) The Central Corporation should endeavour to give loans in the form of debentures which can, at suitable times, be gradually placed in the market.

(4) The Central Corporation should consider making arrangements with borrowing companies by which it may retain the option of converting the whole or part of a loan granted by it later into equity capital.

(5) The Corporations should give banks an opportunity to participate in the loans sanctioned by them, and should also consider guaranteeing the long-term loans advanced by scheduled banks or insurance companies.

(6) The limit of Rs. 1 crore prescribed for advances by the Central Corporation to any single concern should be relaxed in the case of key industries.

Further, the Committee has recommended that in order to augment the finance available to small industries, a special Development Corporation for small industries should be constituted immediately.

In order to facilitate further expansion of the activities of State Financial Corporations, the State Financial Corporations Amendment Act authorizes the Corporations (*i*) to render financial

assistance to the hotel and transport industries, (*ii*) to borrow funds from the Reserve Bank for periods not exceeding eighteen months upto 60 per cent. of the paid-up share capital as well as from State Governments and any notified financial institution (the Refinance Corporation for Industry has since been notified), (*iii*) to undertake the business of guaranteeing (*a*) deferred payments due from any industrial concern in connection with the purchase of capital goods within India and (*b*) loans raised by industrial concerns from scheduled and State Co-operative banks. The amendment Act has also enhanced the limit of accommodation in the case of public limited companies and co-operative societies from Rs. 10 lakhs to Rs. 20 lakhs.

The general opinion is that, although the State Financial Corporations have been in existence for nearly a decade, they have not so far accomplished, by and large, the purpose for which they have been set up. They have not been set up. They have not been able to utilize even the limited funds at their disposal for financing medium and small-scale industries and are not yet able to pay their way. The principal reason for this situation appears to be that the Corporations are very conservative in dealing with applications from industrial concerns for loans and make more detailed and more prolonged enquiries and investigations than are really necessary. Moreover, considerable time is wasted between the sanction and disbursement of the loans on account of the delay by the Corporations and their solicitors in investigating the title to the security offered by the applicants. Further, most of the Corporations insist on the execution of a mortgage deed, which attracts a heavy stamp duty, in respect of the security offered, even in those towns, in which equitable mortgages are permitted by the law. These defects must be removed, if the Corporations are to fulfil adequately the purpose for which they have been established.

9. *Other Corporations.*—In 1955, the Government of India set up the National Small Industries Corporation Ltd. for financing and promoting small-scale industries in India and the National Industrial Development Corporation for establishing and financing medium and large-scale industries in so far as they were incidental to planned development, that is, to fill in the gaps in the industrial structure so as to secure harmonious development in the public and private sectors. At the end of 1961, the former corporation had advanced Rs. 10 crores to

small-scale industries for the purchase of machinery and the latter had advanced Rs. 9 crores to cotton and jute textile and machine tool industries.

In the same year, the private sector established the Industrial Credit and Investment Corporation of India Ltd., with an authorized capital of Rs. 20 crores for finncing industries in the private sector. Its issued capital is Rs. 5 crores, of which Rs. 1½ crores have been taken up by certain, mainly institutional, investors in the U. K. and U.SA. In addition to the substantial loan assistance of Rs. 7.5 crores from the Government of India, the Corporation is allowed to borrow £40 million from the International Bank for Reconstruction and Development and upto £5 million from the U. S. Development Loan Fund. The total financial assistance sanctioned by the Corporation in the form of loans, guarantees and underwriting of, or direct subscription to, shares and debentures, from its inception in 1955 upto the end of 1961 amounted to Rs. 42.7 crores, of which Rs. 18.4 crores were disbursed.

In 1957 the Reserve Bank, four Exchange Banks, eleven Indian Banks and the Life Insurance Corporation of India formed the Refinance Corporation for Industry (Private) Ltd., and contributed jointly to its capital of Rs. 12.5 crores. The Corporation has been formed for providing, through the medium of banks, medium-term loans to medium sized industries. The issued capital has been supplemented by the loan of Rs. 26 crores out of the counterpart funds of the Wheat Loan given by the U. S. Government to the Government of India under P.L. 480. Banks participating in the scheme take the entire risk for the loans which they advance to industrial concerns and thereby relieve the Corporation from the responsibility of investigation of the creditworthiness of the concerns applying for the loans.

In 1961 the Corporation became a public limited company and extended its refinancing facilities to 57 commercial banks, 14 State Financial Corporations and 3 State Co-operative Banks. Out of Rs. 20.07 crores applied for by 21 financial institutions since its inception, the total refinance sanctioned by it upto the end of 1961 amounted to Rs. 16.49 crores covering 92 applications from 17 financial institutions. Since its inception, upto the end of 1961, it had disbursed a total sum of Rs. 6.97 crores on 41 loans and the amount outstanding at the end of 1961 was Rs. 6.47 crores. Further steps taken by the Corporation to enlarge the scope of its activities include the extension of the refinancing facilities to

(*a*) loans made jointly by two or more banks or a bank and term lending institution, provided such loans are eligible under the reference scheme and (*b*) the medium-term part (*i.e.* instalments repayable within 7 to 10 years) of long-term loans.

10. *Suggestions for increasing the financial assistance of commercial banks to small industries* :—The need for a change in the attitude and policies of commercial banks and other financial institutions regarding providing finance to small industries was stressed at the Seminar held in Hyderabad in July, 1959 under the auspices of the Reserve Bank of India. The Seminar came to the conclusion that any policy, which was directed towards increasing the supply of institutional finance to small industries, without raising the cost of borrowing, should be based on a reduction of the risk of loss to the lenders. Accordingly, the Government of India has introduced, on an experimental basis from July 1960, a scheme for guaranteeing loans granted by the State Bank of India, its subsidiaries, 48 other scheduled banks and other financial institutions to small industries in 52 districts. The Reserve Bank of India is the Agent of the Government for working the scheme, which provides for sharing of losses equally between a lending institution and the Government of India, subject to the condition that the maximum amount recoverable against a guarantee issued under the scheme in respect of any one advance will not exceed Rs. 1 lakh. The charge for providing the guarantee is $\frac{1}{4}$ per cent. per annum on the maximum amount of advance (or limit) sanctioned.

The Guarantee Organization received 2,949 applications for guarantee for sums agregating Rs. 10.7 crores up to the end of June 1962, of which guarantees were issued in respect of 2,667 applications for a total amount of Rs. 9.1 crores. Although 26 credit institutions from all parts of the country applied for guarantees, the bulk of the applications were from the State Bank of India.

In providing finance to small industries banks should make greater use of the services of the several Central and State Government organizations which have been set up specially for helping small industries, such as the Small Scale Industries Board, an advisory body, the National Small Industries Corporation Ltd., which supplies machinery under hire-purchase, and a small Industries Service Institute and several Industrial Extension Centres in each State, which give advice on technical

matters and on problems of marketing, accounting, costing and factory legislation. Moreover, the commercial banks should seek the participation of State Financial Corporations or other banks in such finance, wherever feasible. The banks should also re-orientate their ideas of security and enlarge the list of acceptable commodities and inventories and liberalize the terms relating to margins and repayment of loans.

Small industrial units, on their part, should convert themselves into limited companies, plan properly before embarking on their enterprises, improve their methods of production and marketing and raise the quality of their products, so as to become more credit worthy and prepare regular balance sheets and profit ànd loss accounts, with the help of the various special agencies which have been set up by the Central and State Governments for assisting them.

Large banks may follow the example of the State Bank of India, which has established a pilot scheme for financing small industries. Upto the end of 1961, it had made advances to 2811 industrial units against pledge or hypothecation of materials or finished goods and even clean advances in some cases, the amount of outstanding advances being a little over Rs. 5 crores.

11. *Suggestions for tmproving the finance of cottage industries.*— It is necessary to rescue the workers in cottage industries from the clutches of rapacious and short-sighted money-lenders. The small size and scattered nature of the industries will always prevent banks or big financiers, possėssing enlightenment and vision, from interesting themselves in their development. But these very features make the industries admirably fitted for the application of co-operation, and all experts have agreed that the salvation of these industries depends largely upon the development of co-operative institutions.

Small industries are thriving in other countries with the help of co-operation, and a great future lies in front of India's cottage industries, if only co-operation succeeds in providing them with loans at reasonable interest, and raw materials of good quality and improved tools and appliances at reasonable prices, in removing the existing defects in their character, such as ignorance, conservatism, and a lack of ambition and of proper business sense, by propaganda and education, and in helping them to dispose of their products, as it has succeeded in doing in other countries. It is true that the few co-operative societies that

have been so far established among the artisans have not on the whole proved successful, but this has been due to under-capitalization, ineffective by-laws, business inexperience and bureaucratic irresponsibility of the officers of the Co-operative Departments, and a want of sufficient contact between them and the artisans, in contrast to the experience, interest and contact of the money-lenders.

These defects, however, can be gradually removed, if the following principles are borne in mind [1] :—

(1) Co-operation, to start with, should take the form of credit, which is the simplest, the most readily acceptable, and the most educative of all the forms of co-operation.

(2) After the ground is prepared in this way, other forms of co-operation, such as purchase and sale, should be started. Separate societies should be created for the purpose, and the credit societies should not be saddled with these functions. For the formation of co-operative societies there must be close co-operation between the Industries Departments and the Co-operative Departments.[2]

(3) Co-operation should be attempted at first in those industries whose products are readily saleable at more or less stable prices, and the co-operative treatment should be applied to other industries only after success has been achieved and experience has been gathered in the easier cases.

(4) If the urban artisans find it difficult to co-operate under unlimited liability, they may be brought together in the Schultze-Delitzsch type of society, which works on limited liability, and lends to members on the security of two other names.

(5) The officers of the Industries Departments should help the societies with advice on technical matters, the provision of new markets, and the commercial aspects of new schemes.[3] These officers should make a special study of different markets in India and abroad, as this will enable them to give the artisans of their respective areas proper advice regarding the types of articles, which may be in demand, or for which markets may be created.

(6) Government should undertake greater financial responsibilities to foster the movement, and should, on the recommenda-

1 See the writer's *Industrial Labour in India*, pp. 291-4.

2 For the details of this co-operation see the writer's *Wealth and Welfare of the Bengal Delta*, p. 273 and Bengal Committee Report, p. 123.

3 See Bengal Committee Report, p. 124.

tions of the Industries Department, give grants to the societies for operations of an experimental nature or for purposes of demonstration, give them loans for specific purposes, and give a guarantee to central banks financing them for operations in new directions expected to yield a considerable public advantage.[1]

Further, stores similar to the Bombay Swadeshi Stores should be established in the towns and cities of India for the distribution of the products of cottage industries by bringing them to the notice of the inhabitants; more central trading organizations similar to the Arts and Crafts Emporia at Lucknow and Lahore should be created to establish co-ordination and co-operation between isolated cottage industries, and to introduce their wares to suitable markets at home and abroad; licensed warehouses, co-operative wholesale depots, and co-operative sale societies should be established for the storing and sale of the products of cottage industries in commercial centres under the competent guidance of provincial marketing boards; and the Central and Provincial Governments and local bodies should purchase their stores from cottage industries wherever possible.

12. *The part of Government in financing industries and suggestions for improving it.*—Finally, it is necessary to consider the part which Government has been taking in the provision of finance to industries. Under the State Aid to Industries Acts that exist in most States, the Governments of these States can assist new and nascent industries that are registered in India with rupee capital and comply with certain requirements with regard to the constitution of the boards of directors, and also cottage industries. The aid can take the forms of loans at low rates of interest, subscriptions to shares or debentures, guarantee of interest on them, guarantee of cash credits with banks, supply of machinery on the hire-purchase system, grant of land or other Government property and raw materials on favourable conditions, and subsidies for research. The Acts also provide for propaganda, demonstration and technical assistance by the State Governments concerned.

The success of the Acts, until recently, was small. The finance provided under them was small, and a part of it had to be written off, or its recovery was regarded as doubtful. The attempts of the Governments to aid industries were also said to have received little response. The chief reasons were that (1) the

[1] See Bengal Committee Repot,

Departments of Industries, through which the aid was given, were not sufficiently equipped for the work, and were afraid of the heavy banking responsibilites placed on them by the working of the Acts, and that (2) industrialists disliked the publicity and formality attending Government assistance that were regarded as necessary in the interests of the taxpayers, as they affected the credit of the applicants for aid, especially if the applications were rejected. The Shroff Committee recommended that the State Governments should annually make larger budget ary provisions for aid under the above Acts and should simplify the procedure of giving the aid. The situation in this respect has improved recently, and during the second Five Year Plan a sum of Rs. 14 crores was advanced by the various State Governments to small scale industries.

CHAPTER X

THE IMPERIAL BANK OF INDIA AND THE STATE BANK OF INDIA

1. *Its organization.*—This Bank was established in 1921 under the Imperial Bank of India Act of 1920 by the amalgamation of the three Presidency Banks, the Banks of Bombay, Bengal and Madras. Its organization was modified by the Imperial Bank Amendment Act of 1934. It continued to function until 1st July 1955, when it was converted into the State Bank of India by the State Bank of India Act 1955. Its authorized capital was Rs. 11¼ crores, of which a half was paid-up, and the other half was a reserve liability of its shareholders. Of the paid-up capital, Rs. 3¾ crores consisted of fully paid-up shares of Rs. 500 each, and the remainder of quarter-paid contributory shares of Rs. 500 each, the remaining three-fourths value of the shares being the reserve liability of their owners. The Bank's reserve fund amounted to Rs. 6.07 crores. It paid a dividend of 16 per cent. from its inception until 1931, and then paid 12 per cent. up to 1945. In 1946, it paid 14 per cent. and later 16 per cent. The shares were consequently at a high premium.

To safeguard regional interests, and to give the Bank a large freedom in banking, the local head offices of the Presidency Banks in Bombay, Calcutta and Madras, under Local Boards elected separately by the shareholders, whose names stood on

the Bombay, Calcutta and Madras registers, were retained and, with the Secretary and Treasurer as their chief executive officer, administered the business of their respective territories. The general superintendence of the affairs and business of the Bank and the general control of the Local Boards were in the hands of a Central Board. Its functions were determined by by-laws, and it dealt only with matters of general policy, such as the movement of funds from one part of India to another, and the publication of the Bank's weekly statement. The actual executive work was conducted by a Managing Director and a Deputy Managing Director, who were appointed by the Central Board for a period not exceeding 5 years, and whose terms of office could be extended by the Board for such further periods not exceeding 5 years in each case as the Board might think fit.

The Central Board of the Bank consisted of the following Directors :—

(1) the Presidents and Vice-Presidents of the Local Boards;

(2) one person elected from among themselves by the members of each Local Board;

(3) the Managing Director;

(4) such a number of persons not exceeding 2 as might be nominated by the Governor-General in Council. They held office for one year, but might be re-nominated;

(5) the Deputy Managing Director;

(6) the Secretaries of the Local Boards;

(7) a Government officer nominated by the Governor-General in Council.

The Directors mentioned in 5, 6 and 7 were not, however, entitled to vote on any question at any meeting. But the Deputy Managing Director was entitled to vote in the absence of the Managing Director.

On account of the difficulties of holding frequent meetings of the full Central Board, some of its work was delegated to a managing committee consisting of the Managing Director, the Deputy Managing Director, the Government officer, and the President, Vice-President, elected member and Secretary of the Local Board of the place where the committee met. To avoid provincial jealousies, the Central Board had no fixed location, but sat alternately in Bombay and Calcutta, and met at regular intervals, holding additional meetings when necessary. The managing committee met more often.

Until 1935, the Central Board of the Bank consisted of the following Governors :—

(*a*) Nominated by the Governor-General :—

(*i*) Two Managing Governors.

(*ii*) Four Governors, who must be non-officials, and who represented the interests of the Indian community in general.

(*iii*) Three Secretaries of the three Local Boards of Bombay, Calcutta and Madras.

(*iv*) The Controller of the Currency who represented the Government of India.

The Governors mentioned in (*iii*) and (*iv*) attended all the meetings but could not vote.

(*b*) Elected by the shareholders. The Presidents and Vice-Presidents of the three Local Boards.

Until 1935, Government exercised the following control over the Bank, as it acted as the sole banker to Government and as bankers' bank—

(1) It appointed the Managing Governors, the Controller of the Currency, the Secretaries of the Local Boards, and four Governors, as mentioned above. The Controller of the Currency was empowered to hold up any action of the Board affecting the financial policy or the safety of the cash balances of Government, and to refer the matter to Government for its decision.

(2) It could issue instructions to the Bank in any matter which, in its opinion, vitally concerned its financial policy or the safety of its cash balances.

(3) It was empowered to make the Bank supply any information regarding its affairs, produce any of its documents, or publish a statement of its assets and liabilities at such times and in such a form as Government might think necessary.

(4) It could appoint any auditors to examine, and report on, the accounts of the Bank.

(5) Its previous sanction was required for establishing more local head offices and local boards of the Bank.

From 1935 Government abandoned the above control because the Bank ceased to act as the sole banker to Government and as bankers' bank.

2. *Functions of the Imperial Bank.*—Until 1935, the Bank acted as the sole banker to Government. It was the custodian of Government funds, and did the treasury work of Government

free of charge. It received all Government dues from the public, and Government drew upon it for Government disbursements. It also managed the public debt of the Government of India, and provided the machinery for the issue of Government loans. There was, however, a separate public debt which acted as the actual registrar of the debt. This brought about the abolition of Government Reserve Treasuries and the fructification of Government balances, which the Bank could use for assisting the money market.

Moreover, it acted as the bankers' bank, and most of the leading banks in India, including the exchange banks, kept a portion of their cash balance on deposit with it. Further, it supplied the supervising staff to, and managed, the 11 clearing houses that were established in the principal cities of India. It also provided remittance facilities between its numerous branches to the other banks and the public at rates which were controlled by Government, and which varied between $\frac{1}{4}$ and 1/32 per cent. according to the amount remitted and the purchaser of the remittance—a member of the public or a bank. In return the Bank was given the concession of transferring its funds from one place to another within India through the Government Treasury Department free of charge.

To enable it to assist the money market in the busy season, when the bank rate usually rose to 6 per cent., the Paper Currency Department of Government could grant loans to it up to a maximum of Rs. 12 crores at the bank rate subject to a minimum limit of 6 per cent. for the first Rs. 4 crores and 7 per cent. for the remaining 8 crores, on the security of internal bills of exchange or hundis of an equivalent amount. For increasing banking facilities in the country and promoting the banking and investment habit among the people, the Imperial Bank Act provided for the establishment of 100 new branches by the Bank within 5 years. This obligation was carried out, and one-half of the branches were opened at places which had no banking office at all, although some of the branches did not yield any profit. In return, the Bank obtained the use of Government balances free of charge. At those places, where it had no branches, it used the services of other banks or leading local merchants or shroffs for the collection of bills and cheques.

Other functions, which the Bank was authorized by the Act of 1920 to carry on, without modification by the Act of 1934, were as follows :—

(1) Advancing money and opening cash credits on the security of—

(*a*) Securities in which a trustee is authorized by law to invest trust money.

(*b*) Securities issued by State-aided railways notified by the Governor-General in Council.

(*c*) Securities issued under any Act of a Legislature in British India by, or on behalf of, a District Board.

(*d*) Goods, or documents of title thereto, deposited with or assigned to the Bank.

(*e*) Accepted bills of exchange and promissory notes endorsed by the payees.

(1) Fully paid-up debentures or shares of companies with limited liability, or immovable property, or documents of title relating thereto as collateral security, where the original security is one of those specified in (*a*), (*b*), (*c*), and (*d*) above, and if authorized by the Central Board, where the original security is of the kind specified in (*e*).

(2) Advancing money to Courts of Wards upon the security of estates in their charge, with the previous sanction of the Provincial Government concerned.

(3) Drawing, accepting, discounting, buying and selling bills of exchange and other negotiable securities payable in India and Ceylon and, subject to the directions of the Governor-General in Council, the discounting, buying and selling of bills of exchange, payable outside India for, from, and to such banks as the Governor-General in Council may approve.

(4) Investing the Bank's funds in the securities mentioned in (1) (*a*), and (*c*).

(5) Making, issuing and circulating bank-post-bills and letters of credit payable in India and Ceylon.

(6) Buying and selling gold and silver, coined or uncoined.

(7) Receiving deposits and keeping cash accounts.

(8) Receiving securities, plate, jewels, title-deeds or other valuable goods for safe custody.

(9) Selling such properties, movable or immovable, as may come into the Bank's possession in satisfaction of claims.

(10) Transacting pecuniary agency business on commission.

(11) Acting as administrator for winding up estates.

(12) Drawing bills of exchange and granting letters of credit payable out of India for the use of principals in connection with

(7) and also for private constituents for *bona fide* personal needs.

(13) Buying, for the purpose of meeting such bills or letters of credit, of bills of exchange payable out of India, at any usance not exceeding 6 months.

(14) Borrowing money in India for the Bank's business.

(15) Borrowing money in England for the Bank's business upon the security of the assets of the Bank, but not otherwise.

The Bank was prevented by the Act of 1920 from transacting any other business and in particular—

(1) from making any loan or advance :

(*a*) for a longer period than six months ;

(*b*) upon the security of the shares of the Bank;

(*c*) save in cases of estates specified in (2) above, upon mortgage or security of immovable property, or documents of title relating thereto.

(2) from discounting bills for, or advancing money to, individuals or partnership firms, beyond such sums as might be prescribed, except upon a security of the kind specified in (*a*), (*b*), (*c*) and (*d*) of (1) above ;

(3) from discounting or advancing money on personal security, unless such discounts or advances carried with them the several responsibilities of at least two persons or firms unconnected with each other in general partnership;

(4) from discounting or advancing money on the security of any negotiable security having a longer period to run than 6 months;

(5) from dealing in foreign exchanges, except for the *bona fide* requirements of its constituents for their personal requirements; and

(6) from opening accounts at the London branch for persons who, within the previous three years, were not the customers of the Bank in India or of one of the Presidency Banks.

The Bank was freed from some of the above restrictions on its working by the amending Act of 1934 and became free:—

(*i*) to establish branches or agencies at such places in India or elsewhere as it deems advantageous;

(*ii*) to buy and sell foreign bills of exchange or usance not exceeding 9 months if they relate to the financing of seasonal agricultural operations, and 6 months in other cases;

(*iii*) to open cash credits, to receive deposits and to borrow money outside India;

(*iv*) to make advances against goods hypothecated to it instead of being restricted to advances only against goods, which are in its possession, or the documents of title which are deposited with it; and

(*v*) to make advances and to open cash credits on the security of the shares of the Reserve Bank, or of debentures issued under the authority of a municipal board or committee, or with the sanction of the Governor-General in Council, or of debentures issued under the authority of the ruler of an Indian State, or subject to the directions of its Central Board, or of debentures or fully paid shares of companies, with limited liability, registered in India or elsewhere.

It is seen from this that some of the restrictions on the operations of the Bank imposed by the Act of 1920 were continued. This was due to the fact that the Bank continued to occupy a special position as the sole agent of the Reserve Bank.

With the establishment of the Reserve Bank in 1935 the Imperial Bank ceased to be a bankers' bank and banker to Government, but it acted as the sole agent of the Reserve Bank in places where the latter had no branches, under an agreement the terms of which will be explained in the chapter on the Reserve Bank, as the Imperial Bank had a larger number of branches spread throughout the country than any other bank.

Some authorities objected to the working of the Imperia Bank under a special Act after the establishment of the Reserve Bank, and suggested that it should be under the same legislation that was applied to other joint-stock banks, and should take its rank among them as the premier Indian joint-stock bank.[1] Their reason was that the special Act gave the Bank a position and prestige which was opposed to the interests of the other joint-stock banks in India, and that its special privileges enabled it to continue to offer severe and unfair competition to the other banks. On the other hand, if it was left in an unsheltered and unprivileged position, it would be able to appreciate the difficulties against which the other banks were struggling. It would then throw its weight to remove the difficulties, and in seeking to promote its own interests, would also promote those of the banks that belonged to its class. These authorities further suggested that the Reserve Bank should be free to appoint any joint-stock

[1] See Central Committee Minority Report, pp. 279 and 283-5 and Mr. Thakur's statement, Central Committee Evidence, Vol. II, p. 431.

banks as it agents, and to give them the benefit of the use of its balances free from interest.

These suggestions were not accepted by Government and the Legislature because, as the Imperial Bank was the only bank that had branches throughout the country, they thought it necessary to make the Bank the sole agent of the Reserve Bank; and as the Banks' agency business included Government treasury business, they thought it desirable to continue to regulate the working of the Bank by means of a special Act.

Until 1935, the London branch of the Bank acted as the custodian of the cash balances of the Secretary of State, and transacted such business as was entrusted to it by him. While the management of the Government of India rupee debt in London was transferred to it from the Bank of England, it was not entrusted with the floatation and management of the sterling loans of the Government of India. But it could float sterling loans on behalf of Indian public bodies, and although it was not allowed to compete with the exchange banks by engaging in general foreign exchange business, it could rediscount bills of the exchange banks. It could also borrow money in the London money market on the security of its assets. From 1935 the above Government business was taken over by the London branch of the Reserve Bank and the London branch of the Imperial Bank conducted ordinary banking business.

3. *Statement of Affairs of the Imperial Bank.*—The last statement of Affairs of the Bank on 24th June 1955 given on p. 274 brings out the nature of its work.—

Some of the items in the balance-sheet need an explanation. The deposits and accounts were those of banks, public bodies, companies, firms, traders and customers of the Bank. The Bank never paid interest on current accounts. It used to pay 3 and 3½ per cent. on fixed deposits not below Rs. 500 for 6 and 12 months respectively, 3 per cent. on ordinary savings bank deposits repayable at a week's notice and 3½ per cent. on savings bank deposits of Rs. 10,000 and over fixed for 3 months. But, on account of the economic depression, it reduced the interest on fixed deposits for a year to 1½ per cent., declined to accept deposits for 6 months, and also reduced the interest on savings bank deposits to 2 per cent. These changes continued during the Second World War on account of abundance of funds. Acceptances

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will be explained in section 5 of the next chapter. Cash credits have been explained in section 2 of the seventh chapter.

Liabilities	Crores of rupees	Assets	Crores of rupees
SUBSCRIBED CAPITAL	.. 11.25	Government and other Trustee securities	.. 89.57
		Other authorized investments	.. 11.07
Paid-up capital	5.62	Loans, cash credits and overdrafts etc.	.. 84.65
Reserve fund and other reserves	6.35	Bills discounted and purchased	.. 30.95
Deposits and other accounts	208.10	Bills for collection	.. .51
		Premises less depreciation	.. 1.29
		Furniture less depreciation	.. .45
Borrowings from other banks	. 8.0	Money at call and short notice	.. 1.13
Bills payable	. 9.10	Other assets	.. 5.37
Bills for collection	. .51	Balances with other banks	.. 3.39
Other liabilities	. 3.68	Cash in hand and with the Reserve Bank	.. 12.98
Total	241.36	Total	.. 241.36

The Bank financed internal trade to a large extent by discounting the hundis of approved indigenous bankers. It also provided short-term finance to textile industries to some extent by means of clean loans granted on promissory notes signed by two persons or on the personal guarantee of some of the shareholders, and gave loans on the security of produce stored in godowns controlled by itself. Balances with other banks were the accounts opened with other banks to facilitate the collection and payment of cheques.

4. *Benefits expected and realized from the Imperial Bank.*—At the time of the establishment of the Bank, Government expected it to confer the following benefits upon the public, the trading community, other banks and Government itself[1]:—

(1) The pursuit by the Bank of a definite policy of establishing an increasing number of branches throughout India, conducting Government treasury and public debt business and possessing undoubted stability, was expected to supply the urgently needed expansion of banking facilities, to inspire confidence in the public,

[1] See the despatch of the Government of India to the Secretary of State on the Imperial Bank scheme, 1919.

to induce it to deposit its savings with the branches, and to get into the banking habit, and thus to mobilize the capital of the country.

(2) With its numerous branches, with a larger and better distributed working capital, and with a fuller and more elastic use of Government balances, it was expected to be able to finance the internal trade to a larger extent and in a better way, by employing more funds in the rediscount of hundis, and by reducing and steadying the high rate of discount that prevailed during the busy season.

(3) It was expected that the development of Indian joint-stock banks for the finance of the country's trade, agriculture and industries would be stimulated, because, they would have behind them the Imperial Bank, with its numerous branches, upon which they would be able to rely for guidance and assistance, which would train Indians in banking business and make them available to the banks, which would exercise an effective control over their discounts and advances and the creation of deposits, thus minimising the possibilities of a crisis and mitigating its severities if it took place, and which, in short, would serve effectively as a bankers' bank.

(4) While the exchange banks were protected from the competition of the Imperial Bank in their foreign exchange business, they were expected to benefit from the levelling up of the banking standards in India by the latter, and from the facilities for rediscounting their bills afforded by the London branch of the Bank.

(5) It was expected that an increasing proportion of Government balances would be kept with the Bank, that ultimately all the balances would be kept with it, and that this would enable it to give increasing help to the money market of the country.

(6) Government hoped gradually to transfer to the Bank an increasing proportion of its financial and banking work, for which its officers did not possess adequate training and experience, thereby relieving them of much financial responsibility, worry, and public criticism.

(7) It was hoped that the management of the paper currency would be handed over to the Bank when currency conditions became stabilized, and that this would enable the Bank to make Indian currency more elastic, efficient and economical, and to amalgamate the various reserves.

These hopes were realized to an appreciable extent. During 1921-8 the Imperial Bank pursued a vigorous policy of opening new branches, especially in places which had no banking offices before. In 1928 it had 202 branches as against 70 in 1920, *i.e.* more than twice the number of the branches of all the exchange banks taken together and more than one-third of those of the Indian banks. Its deposits amounted to one-third of the total banking deposits in India. Few new branches were opened during 1929-33 as some of the branches had not reached a profit-earning stage, and as the Bank desired to consolidate and strengthen its existing branches before venturing upon new ones. But between 1934 and 1945 it increased its branches from 202 to 433. Moreover, it maintained a high degree of liquidity of its assets, worthy even of a Central Bank. The period of maturity of the bills discounted by it was on the average 60 days only; its loans were kept within strict limits and a large proportion of its cash credits were terminable on demand.

The Bank financed the movement of a large portion of crops by means of advances against stocks, the discount of bills, and the purchase and sale of demand drafts and telegraphic transfers. Moreover, the Bank succeeded in reducing the difference between its own hundi rate and the bazaar hundi rate, reducing their fluctuations, and removing the variations in the rates of the Bombay, Calcutta and Madras markets, thereby giving some elasticity to the credit system and stability to the business of the country.[1] The indigenous bankers were compelled to lower their rates for discounting hundis, because the Imperial Bank discounted them at lower rates. They did this even in some of the localities in which the Bank had no branches, owing to the fear that the Bank might be induced to open branches there.

The rate for borrowing money from the indigenous bankers showed a much smaller tendency to decline, because the Imperial Bank could not lend freely in the mofussil owing to the restrictions on its lending, and because the principles on which the indigenous bankers did business are different from those of joint-stock banking. Further, the competition of the Imperial Bank compelled other joint-stock banks also to reduce their rates not only in those places in which the Imperial Bank had branches, but in some other places also, owing to their fear that the Bank might establish branches there. This benefited the

[1] *Cf.* Rau, *Present Day Banking in India*, p. 48.

cultivators, because the smaller the cost to merchants of borrowing money, the lower was the cost to them of marketing produce, and competition led them to offer better prices to the cultivators for their produce. Moreover, the facilities given by the Bank for the transfer of funds between its local head offices and branches at very low charges proved beneficial to the public, and they were extensively used by the latter, although there was a decrease in their use from 1926.

Finally, until 1935 the Bank served as a bankers' bank to some extent, and gave assistance, with due regard to sound banking methods, to other banks that got into difficulties. When the Alliance Bank of Simla failed, it averted a panic in the country by supplying at once funds to pay off one-half of the demands of the creditors of the Alliance Bank. It, however, did this according to the orders of the Government of India. But, when there were runs on the Tata-Industrial Bank, the Bengal National Bank and the Central Bank of India at different times, the Imperial Bank promptly came to their assistance without any orders from Government. Further, the exchange banks obtained from the Imperial Bank loans against authorized securities when necessary, and were, therefore, able to economise considerably in their idle money. Indian joint-stock banks also generally received the same facility, and some of them were given cash credit facilities according to their needs. Both the classes of banks kept substantial balances with the Imperial Bank.

The Bank also discounted bills endorsed by approved indigenous bankers within limits fixed for each banker, and gave them loans on demand pro-notes bearing two names. It also built up close relations with the provincial co-operative banks of different provinces, and allowed them overdrafts. It was, however, too much to expect the Bank to function fully as a true bankers' bank, because it was a competitor of the other banks in different classes of business. Moreover, the Bank was not bound by the Imperial Bank Act of 1920 to make advances to the other banks against Government or other securities.

The competition of the Imperial Bank, however, with the other banks was often exaggerated. In nearly one-half of the places where the Imperial Bank had branches, there were no other banking offices at all. The question of competition, therefore, arose only in the other places in which there were branches of the Imperial Bank and other banking offices. A lowering of the rates of interest in thse places showed that the joint-stock banks had lost

their semi-monopoly, and that the business community benefited correspondingly. However, some of the Indian banks urged that the Bank gave accommodation to the business community at uneconomically low rates and yet had the highest rate of gross profits, because it had the use of enormous Government funds, free of interest. But this benefit was largely offset by the special restrictions that were imposed on its working and by its increased expenditure connected with its free services to Government. Moreover, the proportion of its public to private deposits never exceeded one-sixth. Hence it appears that the higher rate of gross profits of the Imperial Bank was largely due to its ability to attract deposits at lower rates on account of the greater confidence felt in it by the public owing to its better management. Further, the fact that the proportion of current deposits to fixed and savings deposits was much higher in its case than in that of the other banks, although it paid no interest on its current deposits, showed that its ability to offer accommodation to the public at lower rates was not due to uneconomic competition.

The Imperial Bank endeavoured gradually to win the confidence of the other banks, in order to be able to assume the leadership of the Indian banking system. But as the banking history of England and other countries shows, success in this matter was slow and difficult. The Imperial Bank was handicapped by the false notion of the banks and the public that a bank seeking assistance from it was bound to be in a very weak condition. The posit on, however, improved later and it gave valuable help to certain banks, as mentioned above. The wiser banks understood its real position from an early date and kept a substantial portion of their cash balances with it.[1] Others followed, and the relations between it and the other banks were fairly cordial on the whole.

In spite of the creation of the Reserve Bank, the Imperial Bank continued to occupy a unique position. Although, Government balances and certain other accounts were transferred from it to the Reserve Bank, the total deposits of the Imperial Bank were still larger than the Indian deposits of all the Exchange banks and not very much less than those of all the Indian banks. Moreover, while the loans and advances made by the Reserve Bank were very small, and the bills, excepting Treasury bills, non-existent in its portfolio, they were always considerable in the case of the Imperial Bank. This showed that the Imperial Bank served

[1] *Modern Banking in India*, p. 90.

largely as a buffer between the Reserve Bank and the money market. On account of the past position, immense resources and great prestige of the Imperial Bank, the Reserve Bank had to share the control and guidance of the money market with it, and will have to continue to do so with its successor, the State Bank of India, at least for a fairly long period. Although not required by law, the Imperial Bank published a weekly statement of its affairs, like the Reserve Bank and unlike all other banks. This statement was as important as that of the Reserve Bank for a proper appreciation of the conditions of the money market.[1]

5. *Why the Imperial Bank was not developed into a Central Bank.*— We may now proceed to the question, why the Imperial Bank, which had been performing some of the functions of a Central Bank, was not developed into a full Central Bank, and why a new institution called the Reserve Bank of India was established for performing all the functions of such a bank. The chief reason for this was that the Imperial Bank could not be converted into a Central Bank without depriving it of its commercial banking functions. The working of a Central Bank must be absolutely safe, and its assets must have a maximum of liquidity. These requirements would have been endangered by the performance of commerical banking functions by a Central Bank. The acceptance of deposits from the public and the payment of interest on them would have increased its liability and risk, and endangered the liquidity of its assets, as it would have had to pay great attention to its earnings, and so it might have had to engage in risky business, which it ought to have avoided.

Moreover, it would have found it difficult to function as a true bankers' bank and to give help to other banks when they needed it, because the bank might have had to repay the deposits and to give loans to its customers at the same time, although many of its securities might not have been liquid. Further, it would have been unfair on the part of a Central Bank to use its special privileges to enter into competition with the commercial banks of the country. Finally, the managers of the bank should not have been prevented from concentrating themselves on central banking functions by having to deal with commercial banking, which would have strained their energies and judgment and caused them distraction.

If the Imperial Bank had been given the functions and status

[1] See Ghose *A Study of the Indian Money Market*, p. 76.

of a Central Bank without depriving it of its commercial banking functions, it would have become far more powerful, and would have been able to offer serious competition to the other banks in the country. In this connection Mr. Kisch, the Financial Secretary at the India Office expressed the opinion to the Hilton Young Commission on Indian Currency and Finance that the holder of the ultimate reserves of the country should not itself be the channel through which credit was given to individuals and firms.[1]

Moreover, the Bank could not have functioned adequately as a bankers' bank, if it had become an active rival of the other banks, because it might have been tempted to withhold sufficient help from its rivals even if they needed and deserved the help, and because they, far from regarding it as their saviour in their time of need, would have been always suspicious of its attitude towards them, and jealous of its special privileges. Further, the Bank would have been suspected generally of managing the currency more in its own interests than those of the country. Furthermore, loading the Bank with commercial, as well as central banking functions would have thrown upon it a heavy burden and would have made its working cumbrous, difficult and inefficient.

It was asserted that unless the Reserve Bank in India transacted commercial banking work, it could not get sufficient business and, therefore, could not earn adequate profits. It may, however, be pointed out that the bank's work of rediscounting the bills of other banks would develop gradually, and that in the meanwhile, its special privileges, including the right of note issue, would yield it a fair margin of profits. Moreover, a national institution like the Reserve Bank must subordinate the question of profits to the development of a sound banking system in India.

It becomes clear, therefore, that if the Imperial Bank had been developed into a Reserve Bank, it would have been necessary to deprive it of its commercial banking functions, although it had been performing them successfully. India would then have been deprived of the advantages of the widespread and elaborate organization that has been built up throughout the country to provide it with vitally required commercial banking facilities, and to help it to develop the banking and investment habit.

[1] See Minutes of Evidence of the Commission, Vol. V, p. 132.

It was, therefore, necessary not only to leave the commercial banking functions of the Bank entirely undisturbed, but also to remove the restrictions that had been imposed upon them owing to the Bank's performance of a few central banking functions. When the latter were handed over to a new and separate Reserve Bank, there was no difficulty in removing the restrictions upon the commercial banking functions of the Imperial Bank, and allowing it to conduct its activities as freely as any commercial bank in the country, and thus to provide larger, better and cheaper banking facilities to the Indian community. The Central Legislature and Government decided, therefore, to adopt the proper course *viz.* to establish a new bank, to be called the Reserve Bank of India, to hand over all central banking functions to it, and to make it a true Central Bank.[1]

6. *Defects in the organization and working of the Imperial Bank.*—The following defects in the organization and working of the Bank were mentioned by some :—

(1) Its administration, with three permanent head offices in Bombay, Calcutta and Madras, was top-heavy. Considerable savings could be made by giving it a single head office.

(2) Although the Legislature and the Government of India had already accepted the principle that, when an institution received help from the State, its management should be preponderatingly in the hands of Indians, there was no provision in the Imperial Bank Act to secure a majority of Indians among the Bank's shareholders, and Central and Local Boards, and a little more than half of the paid-up capital of the Bank belonged to non-Indians.

(3) The superior staff of the Bank was largely non-Indian, and it was asserted that the rate of its Indianization was too slow and that further recruitment of non-Indians was continued until 1930. Consequently, some of its branches were unprofitable and its services rather expensive. The Managing Governor of the Bank stated that a vigorous policy of Indianization was now being pursued by the Bank.[2]

(4) It was said that as a result of all these factors the Bank resorted to racial and political discrimination to some extent, in granting financial accommodation, that Indians did not always get the accommodation to which their assets entitled them, and

[1] *Cf.* the Report of the Hilton Young Commission on Indian Currency and Finance 1926, pp. 34-5.

[2] See his answers, Central Committee Evidence, Vol. III, p. 874.

that non-Indians were frequently given larger credit than that to which they were entitled on business principles. The close alliance between the Bank and British commercial interests in India persisted, although less so than formerly.

(5) The exchange banks had developed a close understanding with the Imperial Bank. The Imperial Bank had on deposit much larger balances from the exchange banks than from the Indian banks, gave them larger overdrafts, acted as their agent in the interior for the collection of bills and cheques and for other business, and managed the clearing houses, the majority of the members of which, in many cases, were the exchange banks. Finally, the fact that the staffs of the Imperial Bank and the exclusive banks were non-Indian and, in respect of the British exchange banks, had a common nationality, provided a bond between them. It was said that the attitude of the Imperial Bank to the Indian joint-stock banks was much less friendly.[1]

(6) The method employed to secure the extension of banking facilities in India, *viz.* providing the Bank exclusively with interest-free Government balances and encouraging it to establish new branches was regarded as unduly costly by some, and it was asserted that if this privilege had been withdrawn, the Bank would have been compelled to shut up some of its branches. It was also felt by some that the Bank had been using its branches more for collecting deposits in the interior and withdrawing them for use to the few financial centres in India than for financing the trade of the interior which had supplied the deposits.

7. *Nationalization of the Imperial Bank.*—In February 1948, the Finance Minister of the Government of India announced in the Constituent Assembly (Legislative) that his Government had accepted the policy of nationalizing the Imperial Bank along with its decision in favour of the nationalization of the Reserve Bank, but that as the former Bank had branches in Pakistan, Ceylon and Burma, *i.e.* outside India, Government would have to examine carefully the various technical questions that would arise in connection with its nationalization before the policy could be implemented; that although it was not the intention of Government to nationalize other commercial banks, the Imperial Bank, which had been incorporated by a special Act of the Indian Legislature stood on a different footing; and that Government would acquire the shares of the Bank at the average of their

[1] See Central Committee Minority Report, pp. 274-77.

monthly market value during a period to be determined later and issue in lieu thereof to the shareholders long-dated stock of equivalent value and appropriate maturity. This decision of Government accorded with the enthusiasm for nationalization that it generally displayed during the first few months of independence.

In a memorandum submitted to the Government of India, the Central Board of Directors of the Imperial Bank countered the argument of Government that the Bank stood on a different footing from other Indian commercial banks by pointing out that the reason for passing a special Act was to lay down the principles on which the business of the Bank should be conducted and that the Act merely provided the ordinary prudent safeguards. They expressed the fear that if the experienced directors of the Bank were replaced by Government nominees, the work of the bank would suffer.

They further pointed out that although the Bank had benefited formerly from acting as the agent of the Reserve Bank in places where the latter did not have offices, it had latterly been conducting this business at a loss owing to the lowering of the rates of remuneration under the latest agreement with the Reserve Bank, followed by a fall in the volume of Government funds handled by it; and that, therefore, if Government intended to nationalize it on account of this privilege, it was prepared to give up the handling of Government business, to stand on the same footing as the other commercial banks and to be governed by the general banking legislation, instead of the special Bank Act.

Then they pointed out that the Bank had 28 branches and 55 sub-offices in Pakistan, 6 branches and one sub-office in Burma and one branch in Ceylon; that, for the satisfactory financing of India's trade with these neighbouring countries, it was very necessary for their bank to have offices in these countries, as the other Indian banks had closed most of their offices in Pakistan and had hardly any offices in the other two countries and as there were no dependable Pakistani, Burmese or Ceylonese banks, from the Indian view-point; and that their Bank's offices in Pakistan were well-managed and profitable, on account of the control exercised by a local head office and board at Karachi in a newly established Pakistan circle.

Lastly, they stated that their Bank was so efficient from the view-point of banking services rendered to the public anc

economical from the view-point of its expense-ratio that its position would hardly change, even if it were to lose the Government business as agent of the Reserve Bank and that most of its staff was Indian, except about 72 European officers, all of whom would retire between 1950 and 1955.

The shareholders of the Bank also opposed its nationalization. The Bombay Shareholders' Association did the same. Both of them expressed the opinion that the Bank should be relieved of Government business, if it was to be nationalized on that account, and should be allowed to confine its operations entirely to normal banking business.

Whether on account of these arguments or on account of the cooling of the enthusiasm of Government for nationalization owing to its realization of the great difficulties of running nationalized concerns efficiently, Government announced in 1949 that it had decided to postpone indefinitely the question of the nationalization of the Imperial Bank.

The Rural Banking Enquiry Committee of 1949 recommended that the Imperial Bank should be enabled to establish 270 branches or treasury pay offices in the course of the next 5 years, at those places, where the cash work was done by Government treasuries, by giving it a special rate of remuneration in respect of these new offices. The Committee further recommended that the cash work at the treasuries in places, where the Reserve Bank was not functioning, should continue to be handled by the Government or by the Imperial Bank, as the agent of the Reserve Bank, as the Committee did not consider that a stage had been reached, at which a change from the pattern in force for the conduct of Government business in the States would be desirable. In making this recommendation, the Committee envisaged the role of the Imperial Bank, as an auxiliary of the Reserve Bank in the future. The Committee also recommended that steps ...ld be taken to amend the constitution and the working of ... Imperial Bank, so as to emphasize and underline its semi-... and national character. For this purpose, the Committee ... that some of the powers of Government over the Bank, ... to lapse in 1934, should be resumed by Government ... the organization of the Bank should be decentralized by establishi... ...ore local head offices.

...e Co... ...admitted that a section of public opinion ... the cou... ...very distrustful of the Bank, in view of its

past attitude towards Indianization and credit policy and owing to the fact that it was dominated at the policy level by foreign elements. But the Committee expressed the opinion that, in view of the completion of the Indianization of the Bank by 1954, undue importance should not be given to past prejudices and controversies, in considering the part which the Bank should play in future treasury arrangements in the country.

The Committee of Direction, All-India Rural Credit Survey, appointed by the Reserve Bank of India, pointed out in its report, published in December 1954, that the programme laid down by the Imperial Bank of India envisaged the establishment of only 114 new branches at the end of 5 years commencing from 1st July 1951, that this programme was not even half that recommended by the Rural Banking Enquiry Committee and that a far more rapid programme on the part of the Bank of establishing new branches was essential for the provision of banking, credit and remittance facilities to rural and semi-urban areas, whose economic development could not be brought about without the provision of the facilities to them. The Imperial Bank could not carry out the ambitious programme for establishing new branches recommended by the Rural Banking Enquiry Committee, as the new branches would not have been remunerative for several years and as its shareholders, the majority of whom belonged to the middle class, could not reasonably be expected to see their dividends substantially reduced and their incomes lowered even in the interests of the country. The same difficulty would have arisen in the case of other commercial banks and it was aggravated by the Tribunal Awards which raised their establishment expenditure. The Committee, therefore, recommended the conversion of the Imperial Bank of India into the State Bank of India and the amalgamation of ten major State-associated banks, namely, the State Bank of Saurashtra, the Bank of Patiala, the Bank of Bikaner, the Bank of Jaipur, the Bank of Rajasthan, the Bank of Indore, the Bank of Baroda, the Bank of Mysore, the Hyderabad State Bank and the Travancore Bank and certain other small S[illegible] associated banks with it. The object was 'the creation of a st[illegible] integrated, State-sponsored commercial banking institution [illegible] an effective machinery of branches spread over the whol[illegible] which by further expansion can be put in a position to [illegible] cash work from non-banking treasuries, provide vastly [illegible] remittance facilities for co-operative banks [illegible]her ban[illegible] thus stimulating the further establishment of [illegible]nks.'

The Government of India accepted the recommendation and Parliament gave effect to it by passing the State Bank of India Act 1955, in spite of the opposition of the shareholders of the Bank and the business community. Apart from the considerations mentioned above, the enthusiasm of the Government of India and Parliament for nationalization which had fagged for a few years, was given a new lease of life by the resolution passed by the Congress for establishing a socialistic pattern of society at its annual session held at Avadi in 1954. The amalgamation of the State-associated banks with the State Bank of India was postponed for a little while.

8. *Organization of the State Bank of India* :—The State Bank of India began to function under the State Bank of India Act from 1st July 1955. The shares of the Imperial Bank were transferred to the Reserve Bank and the shareholders were given a compensation of Rs. 1,765-10-0 per fully paid share and a quarter of this amount per partly paid share, the compensation being paid in cash up to Rs. 10,000 and, above this amount, in $3\frac{1}{2}\%$ Bonds of the Government of India repayable in 1965. The shareholders were given the option of taking up the shares of the State Bank of India in lieu of the above compensation at the rate of Rs. 350 per share of the paid-up value of Rs. 100. The Central Board of Directors of the State Bank may from time to time increase the issued capital beyond Rs. 5,62,50,000 held by the Reserve Bank, but no increase in the issued capital can be made in such a manner that the Reserve Bank holds at any time less than 55 per cent. of the issued capital of the State Bank. No increase, however, in the issued capital beyond Rs. $12\frac{1}{2}$ crores can be made without the previous sanction of the Central Government.

No person can be registered as a shareholder of the State Bank in respect of any shares held by him, whether in his own name or jointly with any other person in excess of 200 shares. This restriction, however, does not apply to the Reserve Bank, a corporation, an insurance company, a local authority, a co-operative society and a trustee of a public or private religious or charitable trust. But no shareholder, other than the Reserve Bank, can exercise voting rights in respect of any shares held by him in excess of 1 per cent. of the issued capital.

The Central Office of the State Bank is located in Bombay and the Bank has Local Head Officers in Bombay, Calcutta and

Madras. It can have more Local Head Offices at such other places in India as the Central Government, in consultation with its Central Board, may determine. The State Bank must maintain as its branches or agencies all branches or agencies of the Imperial Bank taken over by it and must in addition establish 400 more branches within 5 years in accordance with the programme drawn up by the Central Government from time to time in consultation with the Reserve bank and the State Bank. No branch so established can be closed without the previous approval of the Reserve Bank. The State Bank may establish branches or agencies at any place outside India. The general superintendence and direction of the affairs and business of the State Bank have been entrusted to the Central Board of Directors which, in discharging its functions, has to act on business principles, regard being had to public interest. In the discharge of its functions, the State Bank must be guided by such directions in matters of policy involving public interest as the Central Government may, in consultation with the Governor of the Reserve Bank and the Chairman of the State Bank, give to it.

The Central Board consists of :—

(*a*) a Chairman and a Vice-Chairman appointed by the Central Government in consultation with the Reserve Bank and after consideration, except in the case of first appointment, of the recommendations made by the Central Board in that behalf.

(*b*) Not more than two Managing Directors appointed by the Central Board with the approval of the Central Government.

(*c*) Six directors elected by the shareholders other than the Reserve Bank.

(*d*) Eight directors nominated by the Central Government in consultation with the Reserve Bank to represent, as far as possible territorial and economic interests and in such manner that not less than two of them have special knowledge of the working of co-operative institutions and of rural economy and the others have experience in commerce, industry, banking or finance.

(*e*) One director nominated by the Central Government.

(*f*) One director nominated by the Reserve Bank.

On the first constitution of the Central Board, all the directors were appointed by the Central Government. All the directors

of the Central Board first constituted, other than the Chairman, the Vice-Chairman and the Managing Directors, had to retire at the expiry of two years.

The Chairman, the Vice-Chairman and the Managing Directors hold office for such term, not exceeding five years, as the Central Government may fix when appointing them and are eligible for re-appointment. The directors elected by the shareholders and nominated by the Central Government to represent territorial and economic interests hold office for four years and are eligible for re-election or re-nomination. Other nominated directors hold office during the pleasure of the authority nominating them.

At each place where the State Bank has a Local Head Office, a Local Board has been constituted consisting of all the directors elected to the Central Board by the shareholders or nominated to the Central Board to represent territorial and economic interests and ordinarily resident in the area served by the branch register of the Local Head Office and such number not exceeding four elected by the shareholders whose names are entered on the Branch Register or nominated by the Central Government in consultation with the Reserve Bank as may be prescribed. A Local Committee may be constituted by the Central Board for any area consisting of such number of members as it may determine. A Local Board and a Local Committee can exercise such powers and perform such duties as the Central Board may assign to them.

No person is qualified to be a director of the Central Board or a member of a Local Board or a Local Committee, if he holds the office of a director or manager of any banking company, or is a salaried officer of Government not specially authorised by the Central Government to be a director or member or has been removed from the service of Government on a charge of corruption or bribery or holds any office of profit under the State Bank other than the office of Chairman, Vice-Chairman or Managing Director or has been adjudicated an insolent or has suspended payment of his debts or has compounded with his creditors or is of unsound mind or has been convicted of any offence involveing moral turpitude or, in the case of an elected director, is not registered as a holder in his own right of unencumbered shares in the State Bank of a nominal value of at least Rs. 5,000 and, in the case of an elected member, of a nominal value of at least Rs. 1,000. The nomination or election as director of the Central Board or

member of a Local Board or of a Local Committee of any person who is a member of Parliament or the Legislature of any State becomes void unless within two months he ceases to be a Member of Parliament or the State Legislature and if any director or member is elected or nominated as a member of Parliament or any State Legislature, he ceases to be a director or member.

9. *Business of the State Bank.*—The State Bank can transact the following businesses :—

1. Acting as Agent of the Reserve Bank at all places in India where it has a branch and where there is no branch of the Banking Department of the Reserve Bank, for paying, receiving, collecting and remitting money, bullion and securities on behalf of any Government in India and transacting any other business which the Reserve Bank may from time to time entrust to it.

2. The advancing and lending of money and the opening of cash credits upon the security of :

(*a*) stocks, funds and securities in which a trustee is authorized to invest trust money;

(*b*) Debentures or other securities issued by or on behalf of a District Board, Municipal Board or other local authority, under the authority of law;

(*c*) Debentures of companies with limited liability, subject to such directions as may be issued by the Central Board;

(*d*) Shares and debentures of corporations established under law, subject to such directions as may be issued by the Central Board;

(*e*) Goods which, or documents of title to which, are deposited with or assigned to the State Bank as security;

(*f*) Goods which are hypothecated to the State Bank as security;

(*g*) Accepted bills of exchange and promissory notes endorsed by payees and joint and several promissory notes of two or more persons or firms unconnected with each other in general partnership;

(*h*) fully paid shares of companies with limited liability or immovable property or documents of title relating thereto as collateral security only where the original security is one of those specified in (a) to (e) above and subject to such directions as may be issued by the Central Board, where the original security is one of the kinds specified in (f) and (g) above.

3. The selling and realization of the proceeds of sale of any promissory notes, debentures, stock receipts, bonds, stock shares, shares, securities or goods which, or documents of title to which, have been deposited with or pledged, hypothecated, assigned or transferred to the State Bank as security for such advances, loans or credits or which are held by the State Bank or over which the State Bank is entitled to any lien or charge in respect of any loan, advance, credit or claim of the State Bank and which have not been redeemed in due time.

4. The drawing, accepting, discounting, buying and selling of bills of exchange and other negotiable securities.

5. The investing of the funds of the State Bank in any of the securities mentioned in (a) to (e) of 2 above and the conversion of the same into money whenever required.

6. The issuing of demand drafts, telegraphic transfers and other kinds of remittances made payable at its own offices, the purchasing of drafts, telegraphic transfers and other remittances and the making, issuing and circulating of letters of credit to order or otherwise than to the bearer on demand.

7. The buying and selling of gold and silver.

8. The receiving of deposits and keeping cash accounts.

9. The receiving of all kinds of bonds, scrips, title deeds or valuables on deposit or for safe custody.

10. The selling and realizing of all property, whether movable or immovable, which may come into the possession of the State Bank in satisfaction of its claims and the holding of any right, title or interest in any property which may be the State Bank's security for any loan or advance.

11. The acting as agent of any co-operative bank which is registered under any law in force.

12. The underwriting of the issues of any stocks, shares, debentures or other securities in which the State Bank is authorized to invest its funds under 5 above.

13. The transacting of pecuniary agency business on commission.

14. The administration, whether alone or jointly with other persons, of estates for any purpose, whether as executor, trustee or otherwise.

15. The drawing of bills of exchange and the granting of etters of credit payable out of India.

16. The buying of bills of exchange payable out of India at any usance not exceeding 15 months in the case of bills relating

to the financing of seasonal agricultural operations or six months in other cases.

17. The borrowing of money for the purposes of the business of the State Bank and the giving of security for money so borrowed by pledging assets or otherwise.

18. The advancing or lending of money to, or opening of cash credit in favour of, any company having a Rupee share capital or any co-operative society registered under any law in force, for the purpose of averting the winding up of the company or society or, where any such company or society is being wound up, for the purpose of facilitating such winding up, for any period upon the security of the assets of such company or society.

19. With the approval of the Reserve Bank, the subscribing to, buying, acquiring or holding and the selling of any shares in, or the capital of any banking institution and the forming or conducting of any such banking institution as a subsidiary of the State Bank.

20. The doing of any other kind of business which the Central Government, in consultation with the Reserve Bank or on the recommendation of the Central Board, may authorize.

The State Bank must not make a loan or advance.

(*a*) for a longer period than six months except as otherwise provided in the Act; or

(*b*) upon the security of stock or shares of the State Bank; or

(*c*) upon the security of any immovable property or the documents of the title relating thereto, except to the extent necessary for any purpose of the Act.

The State Bank cannot, except upon a security of the kind specified in (a) to (e) of 2 above, discount bills for any individual or firm for an amount exceeding in the whole at any one time such sum as may be prescribed or lend or advance in any way to any individual or firm an amount exceeding in the whole at any time such sum as may be prescribed. The State Bank cannot discount or buy or advance or lend or open cash credits on the security of any negotiable instrument of any individual or firm payable at the place where it is presented for discount which does not carry on it the several responsibilities of at least two persons or firms unconnected with each other in general partnership. The State Bank cannot discount, lend or advance or open cash credits on the security of any negotiable security, not being a trustee security, which (a) at the date of the proposed transac-

tion has a longer period to run than 15 months, if the security is a bill drawn for the purpose of financing seasonal agricultural operations and six months in other cases or (b) if the security is a bill drawn after sight, it is drawn for a longer period than 15 months in the case of a bill drawn for the purpose of financing seasonal agricultural operations and six months in other cases. Save as otherwise provided above, the State Bank cannot own or acquire any interest in immovable property except for the purpose of providing buildings or other accommodation in which to carry on the business of the State Bank or for providing residences for its officers and other employees.

The State Bank may, with the sanction of the Central Government, and must, if so directed by the Central Government, in consultation with the Reserve Bank, enter into negotiations for acquiring the business, including the assets and liabilities, of any banking institution. If the terms and conditions relating to the acquisition of any such banking institution are approved by the Central Board and the Directorate of the banking institution concerned and are also approved by the Reserve Bank, they must be submitted to the Central Government, and, after sanction by the Central Government, must, notwithstanding anything to the contrary contained in the Indian Companies Act or the Banking Companies Act, be binding on the State Bank and the banking institution concerned as well as the shareholders and creditors. Any banking business acquired as above must thereafter be carried on by the State Bank in accordance with the provisions of the Act.

The Act has laid down that the State Bank must observe, except as otherwise required by law, the practices and usages customery among bankers and, in particular, must not divulge any informtion relating to or to the affairs of its constituents, except in circumstances in which it is, in accordance with the law or practice or usage, customary among bankers, necessary or appropriate for the State Bank to divulge such information. Further, the Act requires every director, member of Local Boards or of a Local Committee, auditor, officer or other employee of the State Bank to make a declaration of fidelity and secrecy.

Finally, the Act has provided for the maintenance, by the State Bank, of a special fund, known as the Integration and Development Fund, into which must be paid the dividend payable to the Reserve Bank on the shares of the State Bank held by it and such contributions as the Reserve Bank and the Central

Government may make from time to time. The Fund must be used exclusively for meeting losses in excess of such yearly sum as may be agreed upon between the Reserve Bank and the State Bank and attributable to the branches established by the latter in pursuance of a provision of the Act and such other expenditure as may be approved by the Central Government in consultation with the Reserve Bank.

The State Bank of India Act was amended in 1957 to enable the State Bank to extend medium-term credit to industries in the private sector and to assist thereby the process of industrialization of the country as envisaged in the Second Five Year Plan. Prior to the amendment, the State Bank of India was prohibited from purveying loans and advances for periods in excess of 6 months and against the primary security of immovable property. The latest amendment has removed these restrictions in certain cases and permits the State Bank to give loans and advances for periods in excess of 6 months but not exceeding 7 years. The necessity for this provision arose from the fact that loans eligible for rediscount with or advances from the proposed Refinance Corporation would normally be for periods between 3 and 7 years. The amendment also enables the State Bank, in consultation with the Reserve Bank and subject to the directions of its Central Board, to subscribe to and hold shares or debentures of any financial institution notified by the Central Government, the immediate purpose of this amendment being to authorize the subscription by the State Bank to the share capital of the proposed Refinance Corporation. The State Bank is also authorized under the amended Act to make advances to firms and companies engaged in the financing of hire purchase transactions on the security of book debts etc., subject however to such directions as might be issued by its Central Board from time to time. The latter provision is designed to ensure that the bank would make finance available for hire purchase transactions only in certain essential sectors. Furthermore, in terms of the new provisions, the State Bank is allowed to act as an agent of the Central Government or any State Government or any corporation in implementing schemes for financing the construction of dwelling houses and advancing or lending money in its capacity as an agent from out of the funds placed at its disposal by the Government or any corporation. The bank has also been authorized to lend money to co-operative housing societies formed by its officers or employees for a period in excess of six months. These loans may be granted even on the security of immovable property.

11. *Subsidiary Banks of the State Bank of India.*—As part of its proposals for strengthening the structural base of the banking system and for a wider dispersal of the facilities of currency chests, the All-India Rural Credit Survey Committee had proposed the integration of some State-associated banks with the State Bank of India. Accordingly, the State Bank of India (Subsidiary Banks) Act was passed in 1959. As provided by this Act, eight major State-associated banks, namely the Bank of Bikaner, the Bank of Indore, the Bank of Jaipur, the Bank of Mysore, the Bank of Patiala, the Bank of Travancore, the State Bank of Hyderabad and the State Bank of Saurashtra have become subsidiaries of the State Bank of India. They function separately but their policies are directed by the State Bank. Through their closer association with the State Bank, they are now in a position to render wider and more efficient service to their customers and the public and to contribute to a better mobilization of deposits through extending their network of branches in undeveloped areas. As agents of the State Bank of India, which is the agent of the Reserve Bank, they are entrusted with the custody of currency chests, for undertaking treasury work and offering better remittance facilities to other banks and the public.

Their total deposits and advances increased from Rs. 103.5 crores and Rs. 58.9 crores at the end of 1960 to Rs. 127.2 crores and Rs. 68 crores respectively at the end of 1961. Their investments in Government securities were constant at about Rs. 5 crores. Between 1st October 1959 and 31st December 1961 they opened 103 new branches. As on 31st December 1961 they had in all 443 branches and 47 pay offices. They are making fair progress in the financing of small-scale industries and co-operative institutions. Steps have been taken to bring their working in line with that of the State Bank and to establish a close coordination of policies, particularly in regard to developmental activities.

12. *Policy of the State Bank.*—The Government of India, through the Finance Minister, has given the assurance that it will not interfere with the day-to-day business of the State Bank. Moreover, as seen above, the Act requires the Board of the Bank, in the discharge of its functions, to act on business principles. It has also imposed an obligation on the State Bank to observe the practices and usages customary among bankers and, in particular, to maintain secrecy normally associated with banking transactions. Further, it contains provisions which would make

political or undue administrative interference with the working of the Bank difficult. No member of the Central or State Legislatures can become a director of the Board. Directives by Government in regard to matters of policy involving public interest can only be given through the Reserve Bank and in consultation with the Governor of the Reserve Bank and the Chairman of the State Bank.

It is true that statutory provisions and directives are not always effective in practice. The important safeguard, however, lies in the composition of the Board of Directors entrusted with the administration of the Bank. The first Central Board of the State Bank was one of the most outstanding Boards associated with any corporation or company in India, with Dr. John Mathai as Chairman and Mr. Vaikunthlal Mehta as Vice-Chairman and a majority of other directors consisting of eminent businessmen and financiers, some of whom were directors of the Imperial Bank of India. Such a Board was not likely to submit to undue interference either from the Government or from the Reserve Bank. The same, however, cannot be said of the present Board, whose Chairman is an official, Vice-Chairman a politician and some of the other Directors not comparable with their predecessors.

It was hoped that the State Bank would use the great powers vested in it, for aiding the commercial banks to realize the common objective of expanding banking facilities, particularly in rural areas, and not for competing with them, and would supplement the activities which had been developed inadequately by the commercial banks. This hope has not been realized fully so far and commercial banks have been complaining of the grant by Government of special facilities to the State Bank at their expense.

13. *Achievement of the State Bank.*—The total deposits of the State Bank, which amounted to Rs. 187 crores on 1st July 1955, rose to Rs. 221 and 344 crores respectively by the end of the two succeeding years and to Rs. 441 crores at the end of July 1958, and stood at Rs. 578 crores at the end of July 1962. There was thus a continuous increase in the total deposits of the Bank. They formed about 28 per cent. of the total deposits of all the scheduled banks in India at the end of July 1958. This increase, however, was partly due to the grant by Government of special facilities to the Bank, at the expense of commercial banks, such as compulsion on semi-Government institutions and organizations

receiving any grant from Government to maintain all their deposits exclusively with the State Bank.

The advances, including bills discounted and purchased, of the State Bank, which amounted to Rs. 110 crores in June 1955, rose to Rs. 206 crores in March 1958 and to Rs. 267 crores in March 1962. 70, 12 and 7 per cent. of the advances were industrial, commercial and personal respectively. The Bank's advances to the private sector increased from Rs. 88 crores in 1954 to Rs. 114 crores in 1956 and further to Rs. 148 crores in 1957.

A statutory obligation to open 400 branches within 5 years of its inception was imposed upon the Bank. In 1961, a Sub-Committee of its Central Board recommended a second branch expansion programme of opening 300 new branches in rural and semi-urban areas by the State Bank and its subsidiaries in the quinquennium ending June 1965. As on 31st December 1961, the State Bank had a total of 1954 offices, comprising four Local Head Offices, the office in London, 5 offices in Pakistan, one each in Burma and Ceylon and 671 branches and 271 sub-offices in India. In order to meet partially the losses incurred at its new branches in 1960, the Bank recovered Rs. 7.37 lakhs from the Integration and Development Fund which, as recommended by the Rural Credit Survey Committee, is being built up by the diversion to it of the dividends earned by Government and the Reserve Bank on their State Bank shares. The total number of offices of the State Bank and its subsidiaries stood at 1484 at the end of June 1962.

The State Bank has put into operation a pilot scheme for the provision of co-ordinated finance for small-scale industries, in which Co-operative Banks, Departments of Industries and Industrial Finance Corporations function as participating agencies. The scheme, which was initiated as an experimental measure at nine centres in 1956, operated at 36 centres by the end of 1961. The number of advances sanctioned by the Bank under the scheme was 1791, the limits sanctioned being about Rs. 6.8 crores. In addition, the Bank had sanctioned 1020 advances to small units at other branches, the limits sanctioned being Rs. 3.4 crores. Further, by the end of 1961, the Credit Guarantee Scheme of the Government of India, under which the Government guaranteed half of the advances made by commercial banks to small industries upto limits of Re. 1 lakh, was in operation at 170 offices of the Bank, which had made 1236 applications to the Reserve Bank for guarantee covering advances aggregating Rs. 5.1 crores. The

Bank has liberalised its lending procedure in favour of small-scale industries. Working capital is provided against all those goods which have an assured market. In selected cases, clean accommodation is given and fixed assets are also accepted as security. The Bank makes additional finance available on the guarantee of the Small Industries Corporations and has also agreed to act at pilot centres as the agent of the State Finance Corporations in their dealings with small-scale industries. The Bank hopes to extend the scheme progressively to many more centres all over the country.

The State Bank has been extending special facilities to co-operative societies in such matters as advances against Government securities and repledge of goods, remittance facilities, and advances against the debentures of Land Mortgage Banks. At the end of September 1960, the credit limits sanctioned by the Bank to co-operative banks and co-operative central land-mortgage banks were Rs. 16 and 9 crores respectively. Moreover, the Bank's holdings of the debentures issued by the latter amounted to Rs. 1.1 crores and its advances sanctioned against such debentures amounted to Rs. 9 crores. The Bank has been extending special facilities to co-operative banks for remitting funds, free of charge, once a week, from their headquarters to upcountry branches, so as to assist the movement, back to rural areas, of funds which cities have been drawing from the rural areas. Further, to supplement the resources of the co-operative movement, the Bank has commenced financing co-operative marketing and processing societies on terms and conditions which, while safeguarding the interests of the Bank, take into account the special needs and mode of operation of these societies. Furthermore, the Bank has lent its support to the Central Warehousing Corporation by subscribing to its share capital and has nominated its officers to work on the Boards of Directors of the various State Warehousing Corporations. It has evolved an appropriate procedure for the grant of advances against the security of warehousing receipts and the goods deposited in the licensed warehouses. The Bank had sanctioned advances amounting to Rs. 4–5 crores against these receipts as at the end of 1960.

Finally, the State Bank has been paying special attention to the expansion of its foreign exchange business. The number of foreign accounts with the Bank as well as the number of the Bank's accounts with foreign banks has been steadily increasing

and there has been an all-round progress of the foreign exchange business of the Bank. In addition to providing the usual facilities, such as information, service and packing credits, the Bank has extended the scope of its activities to direct dealings in 17 currencies and has been playing an important role in financing the import of capital goods on a deferred payment basis. It provides facilities for financing the foreign trade resulting from several barter deals and other special arrangements entered into by the Government of India and by the State Trading Corporation. The rupee travellers' cheques which the Bank has recently put on sale in India and abroad have proved to be popular.

The following was the statement of affairs of the State Bank on 30th July 1962 :—

Capital and Liabilities	crores of rupees	Property and Assets	crores of rupees
Issued, Subscribed and Paid-up Capital	5.62	Cash in hand with Reserve Bank	25.01
Reserve Fund and Other Reserves ..	8.20	Balances with other Banks ..	4.08
Deposits and Other Accounts	578.20	Money at Call and Short Notice	2.67
Borrowings from other Banking Companies, Agents, etc.	.21	Investments— Government and other Trustee Securities ..	247.40
Bills Payable ..	12.61	Other Investments ..	8.81
Bills for Collection as per Contra Acceptances, Endorsements	2.54	Advances, Loans, Cash Credits, Overdrafts etc. ..	268.11
and other Obligations per Contra ..	7.95	Bills Discounted and Purchased	15.41
Other Liabilities ..	12.58	Bills for Collection as per contra	2.54
		Constituents' liabilities for acceptances, endorsements etc. per contra. ..	7.95
		Premises, Furniture and Fixtures less depreciation ..	3.51
		Other Assets	42.42
	627.91		627.91

Chapter XI

THE MONEY MARKET AND RELATIONS BETWEEN THE DIFFERENT PARTS OF THE BANKING SYSTEM

1. *Inadequate connection between the component parts.*—The money market in India may be divided into two parts, the central part, consisting of the Reserve Bank of India, the State Bank of India (formerly the Imperial Bank of India), the larger Indian banks and

the exchange banks, and the bazaar part, consisting of the money-lenders, indigenous bankers, loan offices, chit funds, nidhis, etc., smaller Indian joint-stock and co-operative banks occupying an intermediate position. The connection between these parts is incomplete, as the Indian banking system is somewhat loosely organized and without much cohesion, and until 1935 lacked a a central co-ordinating agency. Until 1935, the central part was largely dominated by Government which controlled the currency, and through it influenced the bank rate decisively. The money market in India, therefore, is defective and, cannot be compared with the highly developed money markets in Western countries.

Owing to the absence of a Central Bank until 1935, the Imperial Bank performed some of the functions of a bankers' bank. The other banks were not bound to keep balances with it, but in practice the exchange banks and the larger Indian joint-stock banks kept a substantial part of their cash balances with it. Its grant of loans to the joint-stock banks against Government securities at the bank rate proved very useful to them, but the high bank rate frequently reduced to a considerable extent the benefits of such loans. On account of the special concessions that the Imperial Bank received from Government, and later from the Reserve Bank also, the joint-stock banks have regarded it more as an unfair competitor than as a friendly supporter, and there was no close connection between it and them. Their feelings towards the State Bank are not much better. They also consider the exchange banks as powerful competitors owing to the latter's large resources and encroachment upon the field of the finance of internal trade at the ports as well as in the interior. The state co-operative banks maintain current accounts with the State Bank, and also get cash credit and overdraft facilities from it.

The central co-operative banks also keep small current accounts with the State Bank and some joint-stock banks. But the primary co-operative societies have connection with other co-operative credit institutions only.

The co-operative banks have no connection with the indigenous bankers and money-lenders beyond the fact that a few of them are depositors or directors of the central co-operative banks. The joint-stock banks feel that the co-operative banks also have begun to compete with them by undertaking business that does not really form a part of co-operation, such as opening current

accounts, the purchase of drafts and the sale of remittance, and the indigenous bankers also have the same feeling.

There is not much contact between the indigenous bankers and the money-lenders, and both of them usually do not maintain accounts with the State Bank and not at all within the Reserve Bank. During the busy season, when the supply of hundis is greater than the resources of the indigenous bankers, a temporary connection is established between a number of them who are selected and placed on an approved list, and the State Bank and the joint-stock banks rediscount the hundis drawn and endorsed by the appoved indigenous bankers up to certain maximum limits determined according to the financial standing of the bankers, or give them advances against demand promissory notes signed by two of them.

2. *Operations of the central or organized part of the money market.*—These may be considered under three heads, the call money market, the bill market and the collateral loan market.

(*a*) *The call money market.*—The Exchange Banks are the chief borrowers of call money, because they often maintain a smaller proportion of cash reserve than the Indian banks. They can do this, as they have a very large quantity of bills and other liquid assets. They may borrow a large amount of call money, when they find that the value of bills offered to them for discount on any day is much larger than that of bills maturing for payment on that day. Indian banks borrow call money to make up a deficiency in the cash balances that they are compelled by law to keep with the Reserve Bank, because otherwise they would have to pay a large fine. Hence, the importance of call money has increased much, since the establishment of the Reserve Bank. The banks may also borrow call money at the end of a year for the window-dressing of their balance-sheets. The lenders and borrowers are usually banks. Large business houses and financiers also lend call money to banks. The transactions may be arranged direct or through brokers. The Exchange Banks and the larger Indian Banks can usually borrow call money, without providing collateral security. Other banks have to provide it in the form of Government securities. The rate for inter-bank call money varies between $1\frac{1}{2}$ and $5\frac{1}{2}$ per cent. according to the slack or busy season, the demand for call money for the purposes mentioned above or for financing speculative dealings on the stock, bullion and produce exchanges, and the supply of call money which depends upon Treasury bill maturities.

(*b*) *The bill market.*—There is no such market in India, except the limited one provided by the Reserve Bank of India since 1952. Banks in India, especially the Exchange Banks, discount bills of approved parties, fulfilling certain conditions, but there is no discount market in India except the limited bill market provided by the Reserve Bank, for further dealings in these bills, and banks have either to keep them until they mature, or rediscount them in the London discount market, if they are export bills. The absence of such a market is the chief hindrance to the drawing of Indian export and import bills in rupees.

In the monetary sphere, a new policy was ushered in November 1951 with the raising of the Bank Rate from 3 to 3½ per cent. and the announcement by the Reserve Bank that it would, except in special circumstances, refrain from buying Government securities to meet the seasonal requirements of scheduled banks. This change in Reserve Bank policy, coming as it did at the start of the busy season, put an effective check on credit expansion. The shift in policy further enabled the Reserve Bank to influence the pattern of bank advances. As banks had to resort to borrowing from the Reserve Bank to meet their seasonal demands, they had to exercise greater caution in their lending operations. Following the change in its open market policy, in January 1952, the Reserve Bank introduced a Bill Market Scheme to enable commercial banks to borrow from the Reserve Bank for meeting their busy season demands. Initially, the Reserve Bank agreed to grant advances under Section 17 (4)(c) of the Reserve Bank of India Act to banks having deposits of Rs. 10 crores or more by way of demand loans on the security of ninety days usance promissory notes of their constituents. Bills arising out of *bona fide* commercial or trade transactions and bearing two good signatures, one of them being that of a scheduled bank, were eligible for rediscount at the Reserve Bank. Advances against such bills were made at one-half per cent. below the bank rate; minimum limits of Rs. 25 lakhs for each advance and of Rs. 1 lakh for each bill were also fixed. Further, the Reserve Bank agreed to bear half the stamp duty incurred by banks in converting their advances into usance bills. Consequent upon representations by the banking community and with the experience gained in the first year, the facilities under the Bill Market Scheme were extended in June 1953 to licensed banks with deposits of Rs. 5 crores or more. One of the recommendations of the Shroff Committee was to extend the

scheme to all scheduled banks with deposits of Rs. 1 crore and above. The Reserve Bank, however, extended the facilities in July 1954 to all scheduled banks in possession of a licence granted by it, irrespective of the size of their deposits. In addition. the minimum limit on advances under the scheme was lowered to Rs. 10 lakhs and the minimum amount of each individual bill was also lowered to Rs. 50,000. That the scheme has proved popular among scheduled banks, is seen from the fact that the advances availed of by them under it during 1952, 1953, 1954, 1955, 1956, 1957 1958, 1959, 1960 and 1961 amounted to Rs. 81, 66, 147, 225, 437, 415 153, 83, 194 and 255 crores respectively. The scheme appears to have become a permanent feature of the credit system of the country and to have given greater elasticity and autonomy to the money market. It has added considerable flexibility to the operations of the Reserve Bank as lender of the last resort and has helped the Reserve Bank to ensure that the advances made under it are for *bona fide* trade purpose and for short periods. It has obviated the need for large purchases and sales of securities by the Reserve Bank in order to adjust money supply to seasonal conditions.

In addition to internal and foreign trade bills, Treasury bills are dealt in by banks. As they are issued at a discount by the Government of India or State Governments and are repayable usually after three months, banks regard tham as a very suitable form of investment for their own surplus funds. Most of them have been issued by the Government of India. During the First World War, they were issued to meet Government's disbursements on behalf of the British War Office. During the post-War period, they were issued to meet budget deficits and to repay the old bills. More recently, they have been issued to provide ways and means for current and capital expenditure, repayment of old bills and conversion of loans. During the Second War, they were issued in large amounts for the same purpose as that during the First War.

Tenders for them are invited by Government notification and are received by the offices of the Reserve Bank. The tenders quoting the lowest discount are accepted, and the bills are issued and paid by the offices of the Reserve Bank. In addition, intermedite Treasury bills are sold sometimes, at particular rates. At least 90 per cent. of the tenders and purchases are made by a few

big banks, and nearly half of these by the State Bank alone. At the most, 5 or 10 per cent. are purchased by private individuals and institutions direct, and not through their banks. This makes Government in India dependent upon a few banks, whereas in London, large funds, which do not belong to banks, are invested in Treasury bills and enable Government there to secure more favourable rates. Consequently, the Reserve Bank has sometimes to intervene and purchase the bills on its own account. The Reserve Bank has been trying to organize and widen the Treasury bill market, in order to secure better control of the money market, with the rediscountability of the bills with itself, and to enable the market to carry a larger floating debt and thereby to reduce the cost of Government borrowing. This, along with the bill market mentioned above, appears to be the best means at present of giving the Reserve Bank control over the money market and enabling it to organize the market. The efforts of the Reserve Bank in widening the Treasury bill market have not succeeded much so far, on account of the absence of a discount market in these bills. Banks are reluctant to discount Treasury bills with the Reserve Bank, because the money market regards such discounting as a sign of weakness. But unless the banks are prepared to discount these bills, they cannot lock up a large part of their funds in the bills. The Reserve Bank should, therefore, take steps to make the banks give up this attitude and consider Treasury bills as an instrument of the money market, to be readily converted into cash whenever necessary, and not as an investment for a definite period. If it succeeds in doing so, the money market would develop greater elasticity and would be more effectively under its control. Sales of Treasury Bills to the public were suspended from 20th December 1949 to 9th September 1952, from 20th April 1954 to 2nd November 1954 and from the 6th April 1956 to 1st August 1958. At the end of March 1961 the outstanding amounts of Treasury Bills in the hands of the public, including joint-stock banks and the Reserve Bank were Rs. 29 and 1106 crores respectively.

(*c*) *The Collateral loan market.*—This is by far the most important part of the money market. Collateral loans usually form more than half of the assets of the scheduled banks and take three forms, *viz.* loan, overdraft account or cash credit. A current account with a bank is necessary for the latter two, but not for the first. Government bonds, shares of first-class companies, agricul-

tural or manufactured commodities, which are easily marketable and do not fluctuate much in price, or orders for their delivery or bullion are acceptable on banks as collateral. Banks keep a margin of 10-20 per cent. on the market value of Government bonds, 30-40 per cent. on that of the shares of first-class companies and 30-50 per cent. on that of commodities. Loans are usually given for a longer period than overdarft or cash credit advances and in many cases are not really within the scope of the operations of the money market, which is concerned with short-term finance. They are usually given for the long-term needs of industries against the security of block capital or for consumption. Overdraft and cash credit advances have been explained in Chapter VII. Businessmen prefer the latter to the former, because banks generally charge a higher rate of interest on loans and charge interest on the full amounts, until the loans are repaid. Banks generally charge a higher rate of interest on a cash credit account than on an overdraft account, because the collateral of commodities obtained for the former cannot be sold as easily as that of bonds and shares obtained for the latter. The rate charged on cash credits is usually 2 to 3 per cent. higher than the bank rate.

3. *Rates in the money market.*—In England, which has been the greatest international source and reservoir of short-term and long-term capital, the long-term interest rate, as determined by the yield of consols or first-class debentures of companies, has been always higher than the short-term interest rate, as quoted for three months' bank bills. The same has been true in the U.S.A. also. But in India, the relationship between these two rates has usually been the reverse of the above normal relationship. During the last 30 years of the 19th century, the short-term rate in India was generally more than 1 per cent. above the long-term rate, as determined by the yield on $3\frac{1}{2}$ per cent. Government securities. This excess has diminished during the present century, especially since the First World War. The causes of this phenomenon have been as follows :—

In India, the largest demand for short-term funds has arisen in connection with the needs of agriculture. But, such finance is short-term finance only in name. On account of the lack of organization in Indian agriculture the proportion of the loans that have to be renewed is so high, that all the loans are regarded as long-term in essence. Moreover, the risk of default has been much higher in the case of such loans than in that of long-term

investment in securities. Hence, higher rates have been charged for them. These rates have influenced other rates in rural areas and ultimately the short-term rates in the organized money market in India. Further, foreign funds have been easily available for long-term investment in India thereby lowering the long-term rate, but have kept away from short-term investment, in spite of its higher rates, owing to the above reasons. The only periods during which the short-term rate in India fell below the long-term one, were the early nineties of the last century, and the early twenties and thirties of this century. The reason for this in the first period was that enormous imports of silver on account of a heavy fall in rupee exchange led to abundance of cash with the banks, thereby depressing the short-term rate. In the second period, the same result was brought about by the inflation of note issue by Government for financing the War, while the long-term rate was temporarily forced up by the exceptional demand for the savings of the public on the part of Government, in connection with the War. In the final period, the short-term rate collapsed on account of the Great Depression.[1]

To turn to rates paid on deposits by banks. In England and the U.S.A., all banks have been pursuing the healthy practice of paying no interest on current deposits because, firstly the necessity of earning interest would have compelled them to invest the deposits somehow even during periods of slack trade; and secondly the total volume of these deposits would have been hardly increased by the offer of interest, as they are regarded by the public as a financial convenience rather than a profitable investment. But, in India, all the banks, except the Imperial Bank, have been paying interest on current deposits. Until the Great Depression of 1930, they paid 2½ and 2 per cent. in the busy and slack seasons respectively. This was nearly half the yield on Government securities. Banks could offer such a high inducement, on account of the abundance of high earning assets in India. But, this practice was a source of weakness to them in the long run, especially as a large proportion of their assets were not quite liquid, on account of the absence of a market in call loans and first-class bills. In 1931, the larger banks reduced

[1] For a full discussion of this problem, see Muranjan, *Modern Banking in India*, pp. 38-56.

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the rate to 1 per cent., later to per ½ cent., and during the Second World War, with its plethora of funds, to ¼ per cent.

In determining the rates of fixed deposits, generally for a year, banks have to take into account (1) the returns on other investments, especially Government securities, (2) sufficiency of the difference between fixed and current deposit rates to compensate for the loss of availability of the fixed deposits, and (3) the rates prevailing in the market for short-term loans. The rate of interest on fixed deposits may vary from the yield on Government securities, according to the condition of business activity, the risk of a fall in the value of the securities and the purposes for which the deposits are held.

In England and the U.S.A, deposit rates are related to the bank rate, being 2 per cent. lower than the latter, and the other lending rates are then adjusted to their economic levels. But, in India, the rate on demand loans of the State Bank is the minimum return on short-term advances in the well-organized financial centres. The rates charged by other banks vary much according to the areas in which they operate, and the kind of business on which they can concentrate, in accordance with the competition that they have to face. A few of them can earn a reasonable profit by lending at rates only slightly higher than those charged in England, while others cannot. Hence, it is clear, as Dr. Muranjan has pointed out, that the Indian banks do not form a homogeneous group and consist of different types.[1] Their common form of organization conceals considerable differences of quality. They have, therefore, been offering deposit rates which have varied substantially from each other, and have had no definite connection with the Imperial Bank rate or the Reserve Bank rate.

Variations in deposit rates in different areas in the case of banks doing different types of business are unavoidable. But, variations resulting from unhealthy competition among banks are a source of weakness to the banking system. Dr. Muranjan has rightly pointed out that uneconomic deposit rates offered by banks lead to risky business and harmful banking practices. In the advanced Western countries, banks fix deposit rates by agreement. In India, regulation of deposit rates, effective and yet elastic enough to attract all potential depositors, will greatly help the progress of banking. Dr. Muranjan has, therefore,

[1] *Modern Banking in India*, p. 60.

suggested that India should be divided into a number of circles, marked from each other, by well-defined financial needs and characteristics, that banks in each circle should be assigned to one of three or more classes according to their type of business, and that each class should have a maximum rate, which banks belonging to that class must not exceed.[1] This suggestion is now applicable only to non-scheduled banks and the smaller scheduled banks, as all other scheduled banks have voluntarily formed an all-India inter-bank agreement fixing maximum rates of interest on deposits, since October 1958.

As regards the rates charged by the banks in India, the only relationship that exists between different money rates is due to basic economic conditions, such as general shortage or abundance of funds and seasonal variations in the demand for them. The definite relationship, that exists between them in the money markets of the advanced Western countries, is absent in India, and the bank rate has had much less importance in the latter than in the former. This is due to the rather loose organization of the Indian banking system, lack of a sense of common interests in the banking community, absence of fully effective central currency and credit authority and obstacles in the movement of capital from one part of the country to another. In the Western money markets, by convention and agreement, definite margins between different market rates and the bank rate are established, according to the costs of different kinds of investments of banks, so as to avoid unhealthy competition between them. Thus, in the London money market, in addition to cash, the liquid assets of banks consist chiefly of bills discounted, and money at call or short notice. Of the latter, the major portion is lent to the discount market, either for a night or for a week, against bills accepted by first-class banks and finance houses. The interest charged on call loans is low, and that on loans given for a week is 1 per cent. less than the bank rate.

The market rate for loans in the London money market is the rate charged for loans given to bill-brokers for a week. The resources of the bill-brokers for discounting bills are made up of loans given by the banks at call or short notice and loans given by finance houses and merchants. Whatever money is, not lent by the banks to the discount market at call or short notice is lent by them to operators on the stock exchange for financing

1 *Modern Banking in India*, p. 63.

the latter's fortnightly settlements. If the discount market for any reason cannot obtain sufficient funds from the banks to finance the bills, the bill-brokers make up the deficiency either by discounting approved bills at the Bank of England at the bank rate, which is the official minimum rate at which the Bank is prepared to discount bills, or by securing loans from the Bank at ½ per cent. higher than the bank rate.

The conditions of the money market in India are in contrast to those described above. There is no convention or agreement to determine the different rates in relation to the bank rate, and the indefiniteness has made it difficult to decide upon the best lines along which credit instruments and practices should be developed. Stock exchange operations seldom play an important part in the distribution of the resources of the various banks. Their holdings of bills are not large, and those that are held are regarded as a definite investment, and are seldom rediscounted. As explained before, the export bills have to be immediately sent out of India for acceptance, and are rediscounted, if necessary, in the London market, and the import bills are held by the exchange banks until they mature. Some of the inland bills get into the hands of the State Bank through the indigenous bankers, but owing to the lack of warehouse receipts it is difficult to separate inland trade bills respresenting the movement of goods internally from finance bills drawn merely to raise funds, and a properly organized market for dealing in such bills does not exist.

The bank rate in Western countries is the rate at which their Central Banks are prepared to discount first-class trade bills. But the bank rate in India until 1935 meant the rate at which the Imperial Bank was ready to give demand loans against Government securities. The movements of this rate had more connection with the loans operations and exchange policy of Government and its balances with the Bank than with the requirements of trade and industry. The rate was often lowered when Government issued a loan, and was sometimes raised to tone up a dull exchange. A reduction in Government balances with the Bank reduced the Bank's cash percentage, and compelled it to raise its rate. This was the result of the powers which Government had under the Imperial Bank Act, owing to its responsibility for the management of the currency. The bank rate was thus a true indicator of the cash position of the Imperial Bank,

and was not always a reliable index of conditions in the money market.

As the security afforded by Government securities was at least as good as that of first-class trade bills, the Imperial Bank rate should have been the lowest rate at which loans could be obtained from the Bank against Government securities. But actually the Imperial Bank hundi rate, *i.e.* the rate at which it discounted or rediscounted first-bills running for 61 days or less, was sometimes higher and sometimes lower than its official bank rate, although there was a close connection between the two. The same is true of its demand loan rate in relation to its hundi rate. Moreover, the bazaar rates, *i.e.* the rates, charged by indigenous bankers for discounting small traders' bills, differed from the official Imperial Bank rate, and still differ from the Reserve Bank rate. The bazaar rates are different in Bombay and Calcutta, and in Bombay city itself the rates are different in the Gujarati, Marwari, and Multani bazaars. These differences show sluggishness in the movement of credit between the different money markets in India.

The call money rate is the rate for surplus funds needing employment for a minimum period of 24 hours, and call money is repayable at the option of both the borrower and the lender. But the bank rate is the rate charged for the use of funds for a definite period, and loans against securities at the bank rate are generally repayable at the option of the borrower only. The call money rate, therefore, should be lower than the bank rate. In Western countries the former tends towards a demand deposit or current account rate, while the latter denotes a lending rate, as the supply of currency and credit is effectively regulated by the Central Banks, which withdraw surplus funds from, or supply additional funds to, the market as required. But in India, during the slack season, sometimes it may be difficult to lend call money at all in the absence of Government treasury bills, and in the busy season it is often available only at the bank rate.

The cause of the difference between the bank rate and the bazaar rates is the existence of the central and the bazaar money markets. The proper connection between the two markets would be a continuous supply of trade bills endorsed by reliable firms or discount houses, which would keep themselves in close touch with both the markets, and which, on the one hand, would supply the needs of the merchants who rely upon the elastic methods

of the bazaar money market, and on the other, would benefit from operations in the central money and discount markets; but such a connection does not yet exist. The aim must be to mobilize all the floating funds of the country, into which bills can find an entry with a minimum delay and a minimum intervention of middlemen, and the Reserve Bank of India can render valuable services in the gradual realization of this aim. The absence of a fixed relation between the deposit rate and the bank rate is due to the rather poor organization of the money market in India, the sound organization of which on modern lines is being attempted by the Reserve Bank of India.

Since November 1962, the larger scheduled banks, except the State Bank of India, have formed an agreement for charging a minimum rate of interest of 6 per cent. per annum on their advances.

4. *Cheap money policy.*—When the international gold standard functioned, the structure of interest rates was largely dependent upon international factors. Its replacement by managed currency systems, in the thirties of this century, enabled the currency authorities to modify the structure to suit domestic needs. The cheap money policy was then launched and Governments in the Western countries reduced the heavy burden of interest charges on their large unproductive debts, incurred during the First World War, by lowering the short-term as well as long-term rates of interest, by means of resorting to loan conversion operations. The necessity of counting the cheap money policy and of keeping the interest rates low became still greater, when, during the Great Depression, Governments were obliged to borrow more, to meet their budget deficits. This was followed by a lowering of the rates for loanable funds in the money market. This policy received the warm support of the celebrated economist Keynes, for stimulating the reduced private investment activity during the Depression. He advocated the same policy even for dealing with a boom.

Throughout the Second World War, all the Governments, knowing that they had to borrow enormous sums, carried out strong measures to prevent a rise in interest rates. An integrated system of controls over commodity, capital and foreign exchange markets enabled the Governments to reduce consumption and investment in the private sector of the economy and to divert the enormous monetary resources, brought into existence by war finance, to their long-term and short-term borrowings.

Banks, whose deposits went on increasing much faster than their advances, and other institutional investors were induced to contribute as much as possible to the Government borrowings. The result was that whereas during the First War, the Government of India's long-term borrowings were on the basis of 5 to 6 per cent. and the treasury bills on the basis of 1½ per cent., during the Second War, the former were on 3 per cent. basis and the latter on ½ per cent. basis, as explained before in section 6 of Chapter VI.

Cheap money policy proved advantageous during the Depression, because it led to monetary expansion, which stimulated a rise in the unduly depressed prices. During the war, it prevented the cost of Government unproductive borrowing from becoming unbearable. Many persons, therefore, throught that it was a remedy for all economic ills and advocated its continuance after the war also, for the maintenance of full employment. The policy proved fairly successful for a year or so, after the cessation of hostilities, but it received a set-back afterwards.

Since the end of the war, private enterprise has needed enormous funds, in addition to the reserve funds accumulated during the war, for the purpose of renewals and extensions of fixed capital, which could not be carried out during the war. Governments also have required very large funds for their development projects. But the supply of loanable funds in the capital market has become much smaller owing to reduction in savings, brought about by high cost of living, high taxation and satisfaction of demand for consumer goods, postponed during the war. Consequently, the interest rates have tended to rise. The persistence in the cheap money policy in these circumstances tended to aggravate inflationary tendencies. On the one hand, prices of industrial securities became inflated, as the capitalization of their yield was calculated on the basis of the lower interest rate. On the other, as the market prices of Government securities tended to fall, on account of the reluctance of investors to keep them, Government agencies, like the Reserve Bank of India, had to purchase large amounts of them, in order to maintain their prices and prevent an increase in their yields. This resulted in putting more currency in circulation, when what was required was contraction of the circulating currency. Such open market operations are beneficial during a depression, but not in an inflationary situation.

An important pre-requisite of cheap money policy is a strictly controlled economy. Cheap money policy can continue only

by the supply of additional doses of liquidity. But the controls had to be abandoned or relaxed greatly during times of peace. Mere expansion of credit, regardless of the rate at which capital equipment becomes available, cannot lead to an increase in real capital. India has been experiencing shortage of capital goods. This has been a physical shortage, which cannot be remedied by monetary policy. In such a situation, cheap money policy became an instrument of inflation.

For these reasons, Governments have been forced to stage an orderly and moderate retreat from their cheap money policy. Thus, while the Governments in Great Britain and India had successfully brought down the rate of interest on medium-term loans to 2½ per cent. by 1946, they were compelled later to raise it first to 3 per cent., then to 3½ per cent. and later to 4 per cent.

The principal beneficiaries of the cheap money policy in India have been the Government, public bodies and the organized section of the money and capital markets. The unorganized section of the markets, consisting of indigenous bankers and money-lenders, has not benefited from the policy, on account of its isolation from the organized section. This isolation has prevented that free flow of funds from the latter section to the former, which would have lowered the rates of interest in the unorganized section. Moreover, indigenous bankers and money-lenders have to charge higher rates of interest, on account of greater risk and inconvenience, resulting from the facts that the financial position of their borrowers is weak and that the former have often to lend to the latter against the security of illiquid assets, such as land, and even personal security. The financial agencies of the organized money market cannot lend direct to such borrowers, on account of their own concentration in certain localities. The benefits of the cheap money policy can be made available to them, only if the indigenous bankers and money-lenders act as intermediaries between the organized section of the market and the borrowers from the unorganized section, instead of confining their operations to lending from their own very limited financial resources, and if the creditworthiness of the borrowers is improved.[1]

5. *Inelasticity and instability of the money market.*—Another characteristic of the money market in India, until economic

[1] See an article on "Cheap Money Policy" by V. R. Cirvante in the Journal of the Indian Institute of Bankers, January 1949.

depression became severe in the country in 1932, was its inelasticity and instability. The fluctuations in the bank rate were rapid and large. It fell to 3 per cent. during the slack season and rose up to 7 or 8 per cent. at the height of the busy season. The instability and uncertainty increased business risk, imposed serious hardship upon the business community, and checked industrial development, which has been dependent, to a considerable extent, upon funds borrowed for short periods. Agriculture and trade in the interior suffered more than business in port towns, as the latter was in a better position to pay high money rates, so that at the height of the busy season money was drained to these centres, and the banks were disinclined to do much business in the interior in order to have the bulk of their funds at the port towns. The cause of the instability was the seasonal stringency of money.[1] The demand for money during the busy season, when the collection and movement of the harvests have to be financed, was abnormal owing to the predominance of agricultural production in India, and the normal volume of currency proved insufficient to meet the demand. But the same volume became excessive during the dull months of the summer and the monsoon, when productive activity of all kinds was necessarily restricted by unfavourable weather conditions.

Until the Imperial Bank of India was established in 1921, Government maintained separate and independent treasuries which withdrew from circulation and locked up large amounts of money received as revenue, at the very time when more funds were needed for financing the movement of crops, and thus aggravated the seasonal stringency. Government finance was thus completely divorced from the money market, and the latter was left to find its own salvation. From 1921 most of the Government balances were kept with the Imperial Bank, which gave the trading community their use until they were required by Government. This helped to alleviate the stringency to some extent. The Government of India and the Secretary of State, however, continued to do independently a substantial amount

[1] On account of the economic depression the Imperial Bank rate remained stationery at 4 per cent. from 7th July 1932 up to 15th February 1933, and at 3.5 per cent. from 16th February 1933 up to 3rd July 1935. The Reserve Bank announced its first official bank rate on 4th July 1935 of 3.5 per cent. This was reduced to 3 per cent. on 28th November 1935 and raised to 3.5 per cent. in November 1951, to 4 per cent. in May 1957, and to 4½ percent. in January 1963.

of banking business, and this produced at times considerable disturbances in the money market.

The crux of the problem was the absence of a bank rate policy due to the fact that, among the great trading countries of the world, India was the only country in which a dual control was exercised over currency and credit. Government controlled currency. The Imperial Bank controlled credit to the extent that it was controlled at all. Divided control meant divided counsels and failure to co-ordinate. If production and trade increase, the demand for credit increases, but the ability of the banks to supply it depends largely upon the amount of currency in their hands. If the amount is insufficient, they have to curtail credit, and this in turn curtails the activities of the producers and traders. There was, thus, no connection in India between the issue of paper currency and the need of the public to get their bills or commodities converted into media of exchange.

The Imperial Bank had some of the privileges of a Reserve Bank, such as a free use of Government balances and a portion of the balances of the other banks, but it did not perform the task of a Reserve Bank. Being primarily a commercial bank and having no responsibility for the supply of currency, it had no stimulus to keep such large cash reserves during the slack season as to be able to meet the stringency of money during the busy season without raising the bank rate unduly. It invested large amounts in Government securities, while trade and industry had to pay high rates owing to the raising of the bank rate.[1] This dual control was a fundamental cause of the lack of elasticity and stability prevailing in the money market of India, until economic depression became severe in 1932. The elasticity of paper currency based on Government securities was very limited, because the amount of the latter that the banks could hold was not quickly expansible, and because it was neither easy for them suddenly to liquidate their holdings in the securities nor desirable for Government that they should do so. The development of the deposit and cheque system also has not been commensurate with the elasticity needed by the country. Further, Government exercised a large control over the bank rate through its power of expanding and contracting currency, as the rate depended to a considerable extent upon the supply of currency. Government could not be deprived of this control over the bank

[1] See Foreign Experts' Report, Central Committee Report, p. 648.

rate and the money market so long as the management of the currency continued to be in its hands.

The inelasticity and instability of the money market was also due to the fact that there was no mobilization of reserves, on the basis of which a credit policy could be made effective. Under the prevailing decentralized system all the banks kept separate reserves. The currency reserve, in the shape of the Paper Currency and Gold Standard Reserves, was locked up with Government. Consequently the reserves of the country could not be used to the fullest extent for the building up of credit, and their capacity to carry out their function of stabilization most economically and efficiently got reduced.

To remove these difficulties, currency and credit had to be co-ordinated, and control over both had to be placed in the hands of a single authority. Government could not be that authority because, not being engaged in banking, it could not keep itself in close touch with trade and industry, and could not possess an adequate knowledge of their varying needs for currency and credit. Moreover, the working of the Government currency mechanism was slow, cautious, and not quickly responsive to sudden changes, and this might have produced disastrous results in an emergency, when producers and traders might have urgently needed additional cash. The controlling authority, therefore, had to be the Reserve Bank, which can readily adjust the volume of currency to the needs of production and trade, because it can base the circulation of its notes directly on business transactions by issuing them in connection with the discounting of bills of exchange.

The Reserve Bank has also done away with the separation of currency and banking reserves by concentrating them in its own hands. A centralized system, with a single central reserve, enables the Reserve Bank to keep during the slack season a higher percentage of gold or sterling reserve against its notes than that required by statute, so that during the busy season the Bank can issue more notes for financing the movement of crops without increasing the reserve. The supply of additional currency by the Bank against proper cover becomes automatic, and there is no need to raise the rate of discount to a penal level on this account. The extension of banking facilities throughout the country that is being promoted by the Reserve Bank is also increasing the rapidity of the circulation of money, and helping prevent the recurrence

of seasonal stringency. Such stringency is not inevitable even in a predominantly agricultural country, and it has been effectively relieved in agricultural countries like Canada and Australia by a sound banking organization. Finally, Government has secured the close co-operation of the Reserve Bank in conducting all its borrowing operations and other banking business, and this has checked a recurrence of the adverse effects of these operations upon the money market.

6. *Influence of Government on the money market.*—The creation of the Reserve Bank has, in theory, ended the direct influence of Government on the money market. But in practice its influence on the Reserve Bank and, through the Bank, on the money market is large, because, in addition to the historical reason explained in the previous section, Government nominates the Bank's Central Board and the Bank's Governor and Deputy Governors. The state of Government balances, however, no longer influences the money market. The long-term borrowing of Government also does not do so. It affects primarily the capital market. It may be urged that large issues of Treasury bills by Government may harm genuine borrowers in the market by locking up large banking funds in the bills. But the borrowers need not suffer, because the bills can be readily discounted with the Reserve Bank and need not reduce the lending capacity of the commercial banks. If the borrowing policy of Government is weak and hesitating and the technique of borrowing unsound, Government may offer rates of higher interest on its borrowings than are necessary, and thereby make also the borrowers in the capital and money markets pay higher rates. But in fact with the help of the Reserve Bank, Government has adopted a sound loan policy and technique, lowered the rates paid on its borrowing, and benefited other borrowers. A sound technique includes skilful open market operations, when necessary. Government possesses the post office savings, the railway reserve and depreciation funds, the provident fund and the debt redemption fund, which it can successfully use to support its loan operations. Finally, the remittance programme of Government has been operated through the Reserve Bank which has been purchasing sterling from the Exchange Banks and those Indian Banks which are authorized exchange dealers and making it available to The High Commission of India through its London office for the purchase of machinery etc. for the projects under taken by the Central and State Governments and quasi-Government bodies

and for meeting the establishment charges of Indian Embassies abroad. The Reserve Bank has been successful in preventing the deleterious influence which the remittance programme formerly sometimes produced on the currency and credit conditions and money market in India.

7. *Scarcity of commercial bills in the money market and suggestions for removing it.*—Another characteristic of the money market in India is the scarcity of commercial bills of exchange, which form a much smaller proportion of the assets of the banks in India than in Western countries. In recent years, the value of bills discounted by the scheduled banks, excluding the exchange banks, has been between 6 and 8 per cent. only of their total deposits. The scarcity is not due to the ignorance of the public regarding their utility or its reluctance to use them, because *darshani* or *muddati* hundis, *i.e.* demand or time bills, have been in use since the 12th century. The scarcity is the result of the following causes :—

(1) Banks in India have preferred investment in gilt-edged securities owing to the need of keeping a stronger liquid position in India than in other countries having more developed banking systems, and owing to the better yield from these securities. This yield, however, has now ceased to be higher than that from discounted bills, and this, combined with the gradual growth of public confidence in the banks, is leading to a reduction in the banks' investment in gilt-edged securities.

(2) The banks sometimes have difficulties in ascertaining the financial standing of the signatories of bills.[1]

(3) Many of the internal bills are finance bills representing money-lending transactions, and are not trade bills drawn in respect of particular business transactions in goods on the conclusion of which they get automatically paid off. But, by looking at a hundi, it is not possible to say whether it is a trade bill or merely finance paper. No railway or warehouse receipts are attached to it. In fact, in several states, it is chiefly used simply as a means to borrow funds or for remittance.

(4) The *muddati* hundi or usance bill has become expensive on account of heavy stamp duties, and has largely disappeared

[1] See the statement of the Bengal Chamber of Commerce, Central Committee Evidence, Vol. II, p. 480.

except in Bengal and the cities of Bombay and Shikarpur. The *darshani* hundi or demand bill has taken its place, but on account of quick transport it is not very useful for granting short-term credit.

(5) The negotiability of certain types of hundis is adversely affected by the fact that custom attaches certain conditions to them. Thus, the *shahjog* hundi is payable only after ascertaining the title and address of the payee. In the case of the *jokhmi* hundi, the drawer or holder, and not the drawee, has to bear the loss, if the goods behind the hundi are destroyed or damaged. To avoid these difficulties, *dhanijog* hundies payable to the holder, *dekhanhar* hundis payable to him who presents then, and *firmanjog* hundis payable to order, have been tried, but the first has proved popular only in Assam, the second only in Bombay and the third nowhere.

(6) Although the Marwari, Gujarati and Multani shroffs and the Nattukkottai Chetties have specialized in the hundi business, they have been generally reluctant to obtain funds from outside. Hence the development of hundis has been hampered by isolation from the organized market for short-term funds.

(7) The bills suffer from lack of standardization in respect of the vernacular and script used, time of presentation and acceptance, days of grace, holidays and procedure if the bills are lost or dishonoured.[1]

(8) The scarcity of bills is also due to the wide prevalence of the system of cash credits, which is advantageous to the borrowers as well as the lending banks, as the borrowers need pay interest only on the portion of the cash credits that they actually use, and as the banks can withdraw the credits, if the financial position of the borrowers goes down. Bills, however, should be preferred by both, because they would give the borrowers certainty regarding a definite amount of credit during the currency of the bills, and at a lower rate, and because, with proper rediscount facilities, they would supply the banks with most liquid assets.

(9) The Central Government have been issuing large quantities of treasury bills. These offer the advantages of liquidity, definite maturity and security, and do not need any grading or endorsement to increase their security. Hence to purchase them, banks do not need the elaborate machinery of a bill market. Banks, therefore, have been purchasing them in large amounts, especially as

[1] See Muranjan, op. cit., p. 127.

the Reserve Bank is prepared to purchase them from the scheduled banks, in case of necessity.[1]

In the opinion of the Central Banking Committee, Foreign Experts and most other experts, the organization of the banking system in India cannot be sound unless the use of commercial bills is developed and an active and efficient discount market is built up. The Reserve Bank of India can gradually bring about this development by co-ordinating the different elements of the money market, establishing a unified control of currency and credit, removing the existing prejudice of the other banks against the rediscounting of bills by operating fully as a bankers' bank and not as a rival institution, and giving them detailed information regarding the bills which will be acceptable to it, and encouraging the more prominent indigenous bankers and their wealthy depositors to organize themselves into discount houses under its protection, rediscounting their bills as freely as those of member banks, and thereby linking up the indigenous bankers and money markets with the large centres where surplus funds accumulate.[2]

Further, the mere issue by the Reserve Bank of additional currency freely during the busy season against trade bills, without raising its rate to an artificial height, can stimulate traders to take an increasing advantage of this cheap and most convenient form of credit. The Reserve Bank should buy or rediscount first-class trade bills or promissory notes of member banks and bankers arising out of *bona fide* commercial transactions, at its published bank rate as the lowest operative rate, and it should exercise its discretion to charge higher rates for discounting the bills of traders lacking bank endorsement, and for giving demand loans against gilt-edged securities, so as to stimulate the use of bills by the banks and bankers.[3] Educational work should be conducted to make traders and producers realize that they would serve their own interests best by fully disclosing their true financial position to their banks, so as to create that knowledge and confidence with regard to the genuine trade character of bills and the financial standing of their signatories, which are lacking in India in many cases at present, but which

[1] See Muranjan, op. cit p. 129.

[2] *Cf.* Central Committee Report, pp. 410-12.

[3] *Cf.* Foreign Experts' Report, Central Committee Report, p. 654, and Bhatter and Nemenyi, *The Reserve Bank of India and its Functions*, pp. 120-1.

are the foundations of the bill market in Western countries, especially in England.

Warehouses and godowns should be established under proper management in different parts of India, as they would help the replacement of finance bills drawn at present by shroffs and merchants by genuine trade bills accompanied by documents, and thereby extend the use of bills, as the latter would be preferred by the banks. The use of bills can be encouraged also by abolishing the stamp duty on them, by keeping for sale in post offices bill forms printed in English and the Indian languages and by passing legislation providing an expeditious procedure for disposing of suits based on negotiable instruments in places in which hundi business is large, validating the noting of dishonour and protest by recognized associations of banks, shroffs or merchants, so as to save trouble and expense to the owners of hundis, and standardizing the essential features of hundis and the customs affecting them in particular areas, so as to promote their circulation under well-defined conditions.

There is much scope for extending the use of bills in several transactions in the country in which they are little used at present. The divorce of agriculture from the money market is an important weakness of the Indian banking system. Co-operative godown societies can be formed, and cultivators can obtain finance on harvested produce by joining them and allowing them to draw usance bills on themselves (cultivators). The societies may then discount the bills with the central co-operative banks, and the latter in turn with the joint-stock banks. The cultivators can also obtain finance on harvested produce by allowing village bankers to draw usance bills on themselves. The village bankers may then discount the bills with shroffs, and the latter in turn with the joint-stock banks. The joint-stock banks should encourage the use of such bills, as they are the best means of promoting co-operation between themselves and the indigenous bankers. As the cultivators' ability to pay the bills would depend upon the sale of the produce, the dates of maturity of the bills should be fixed approximately with reference to the probable dates on which the produce would be sold, always maintaining a safe margin.

With regard to the use of bills in marketing finance, warehouses licensed by State Governments can be established, and with their assistance the village traders can create documented agricultural *muddati* hundis, *i.e.* usance bills, which can be accepted

by the indigenous bankers recognized by the joint-stock banks or the Reserve Bank, and which can later be discounted in the central money market. In respect of the movement of goods from the ports to the interior, the conversion of the open account credit, that is given at present by commission agents to merchants in the interior, into bills will enable the former to obtain credit from the Indian joint-stock banks. As regards the finance of foreign trade, the desirability of creating rupee bills and promoting bankers' acceptances has been considered in the chapter on exchange banks. Finally, banks should prefer the investment of their funds in discounting bills to the system of cash credit because, as mentioned before, with proper rediscounting facilities, the former would supply them with liquid assets. This discounting can take the form of either buying bills held by customers or discounting bills accepted by other banks for their clients.

8. *Suggestions for developing bankers' acceptances.*—The development of banker's acceptances will prove very useful in building up a bill market in India.[1] The U.S.A. until 1913 had practically no bill market, but the country has now a highly developed bill market, owing to the promotion of bankers' acceptances under her Federal Reserve system. A banker's acceptance is a bill of exchange accepted by a bank or firm engaged in the business of granting bankers' acceptance credit. Under this system a purchaser of goods, on whom the seller draws a bill of exchange, arranges beforehand with his bank to have the bill accepted by it, so that the seller can readily discount it with his own bank.

A banker's acceptance is superior to an ordinary bill of exchange for the following reasons:—

(1) It proves to be a better security, carrying as it does the guarantee of a bank and not of an individual. Consequently, another bank is more willing to discount it and at a lower rate so that the drawer gets ready money and cheap money.

(2) The lending capacity of the accepting bank is much increased by the fact that it lends merely credit and not money and, therefore, has not to depend upon the amount of cash with it. For the same reason it charges a very small commission for the service of acceptance, so that its customer obtains credit

[1] See Sir Basil Blackett's statement, Central Committee Evidence, Vol. II, pp. 450-4 and Bhatter and Nemenyi, *The Reserve Bank of India and its Functions*, pp. 131-4.

at a small expense. As the customer provides the money at or before the maturity of the acceptance, he is allowed to turn over his business more quickly.

(3) A banker's accepance is more self-liquidating than other short-term paper, because the accepting bank scrutinizes carefully the transaction on which it is based, and offers all its assets as security for paying its value on maturity. For the same reason it is more readily negotiable and at a lower rate in the market.

(4) Owing to its ready negotiability, it can be sold and resold rapidly among a number of banks and bankers, and thus proves very useful in connecting the up-country money market with the central city market, and in widening the money market and making it more uniform in a country.[1]

Banks in India, therefore, should gradually change their methods and develop acceptance credit as the safest form of lending credit.[2] It will yield them a lower rate of interest than the time-honoured system of overdrafts and cash credits, but as it will increase their lending capacity to a large extent, with the growth of the acceptance business, their profits will not be curtailed. Accepting banks should be supplemented by acceptance associations of indigenous bankers wherever the former find it difficult to establish branches. Both must be registered by the Reserve Bank, which must control their working and regulate their commission charges.

Agricultural producers should be organized into co-operative sale societies, or if this is found difficult, into temporary produce sale societies for the busy season. The societies will draw drafts for acceptance by the banks or acceptance associations of indigenous bankers, and furnish security in the form of produce stored in warehouses belonging to district and taluka boards, banks, Government or the Reserve Bank, and regulated by the Reserve Bank.

So far, with the exception of its bill market scheme, mentioned above, the Reserve Bank has not been able to take any steps for developing a bill market and bankers' acceptances. Moreover, Dr. Muranjan is doubtful whether this development can be brought about in the near future. The reasons given by him are briefly as follows[3]:

1 See Dadachanji, *A Reserve Bank for India and the Money Market*, p. 232.

2 See Bombay and Bengal Committees' Reports, pp. 153 and 127.

3 For a full discussion see his *Modern Banking in India*, pp. 118-30.

(1) A bill market is not the only connecting link between credits and debits and between areas having surpluses and deficits of funds. In many countries, banks have tended to supplant the bill market, with their growth and increase in the number of branches. In the past, bill markets were developed in those countries in which the banks were highly localised or were not allowed to establish branches. But these conditions do not generally exist in India. Hence, direct discounts and collection of bills by branches of banks are likely to come in the way of the development of a bill market.

(2) In India, bill broker-dealers will not be able to get from banks the funds that they will need. The surplus of bank funds in India is seasonal and not steady and as banks have direct discount facilities at the Reserve Bank, they will prefer investing their surplus funds in rediscountable bills to lending them to broker-dealers.

(3) It will be very difficult to alter the recent tendency to prefer the overdraft and the cash credit to the bills. This tendency is noticeable in many other countries also. Intermediaries are being eliminated as far as possible, and the seller instead of drawing a bill on the buyer, throws the burden of arranging the finance on the latter, who creates an overdraft at his bank, pays the debt by instalments and saves in interest. From the banks' point of view, the overdraft need not involve more formalities, or be less certain of repayment on a fixed date, or be less secure than a bill. Moreover, by means of the rates that they quote, the banks themselves can determine which of these two methods of lending should be cheaper.

(4) It will be very difficult to remove some of the other factors mentioned above, which has reduced the volume of bills in India in recent times.

9. *Importance of rediscounting facilities from the Reserve Bank.*—It may be emphasised here that a bill market cannot exist in any country without a Central Bank. No bank, banker or dealer will be willing to buy or discount bills, unless he feels confident that there exists an institution which will always be willing to buy or rediscount them even in periods of monetary stringency. In India, the Reserve Bank alone can give him the confidence that, when in a period of stringency he is pressed for money and cannot obtain it by disposing of the bills in his portfolio elsewhere, he can take them to the Reserve Bank and be sure of ob-

taining the urgently needed funds at the current rate of discount. At such a time the Reserve Bank can buy bills according to the extent of the stringency, and relieve it by pouring its credit into the market smoothly and effectively without causing any panic or even apprehension in the market. When the bills mature, the funds provided by the Bank automatically return to it.

The foundations of the credit organization, on which the development of banking vitally depends, cannot be solid unless the Reserve Bank supplies rediscounting facilities, which alone enable the other banks to convert into cash a maximum of their assets with a minimum of disturbance in the conditions of the money market. Without rediscounting facilities the most legitimate assets of the banks in the shape of short-time advances against goods represented by commercial bills cannot become quick assets readily convertible into cash in an emergency.[1] The second advantage of rediscounting is that it increases the lending power of the banks rediscounting the bills, and gives elasticity to deposit currency in periods of stress. Rediscounting increases the balances of the banks with the Reserve Bank, and as the balances constitute their reserve, they can lend much more to their customers on the basis of the increased balances.

Finally, rediscounting secures the automatic expansion and contraction of the note currency and thus makes it elastic. When the banks rediscount bills and obtain cash, notes of the Reserve Bank get into their hands, and, through them and their customers, into circulation to meet the increased demand for currency. When the bills mature, they are paid in Reserve Bank notes by the banks which accepted them, and the notes thus return to the Reserve Bank; the banks get the notes back from the customers, who had borrowed money, and who complete their transactions by the time the need for additional currency comes to an end.[2]

10. *Suggestions for the organization of an All-India Bankers' Association.*—For a sound working of the money market and the banking system it is essential that its various constituents should be in close touch with each other, so as to secure a proper understanding of their common problems and interests, and an effective co-operation for solving the problems and promoting the interests. The present organization in this respect is very defective. In some large

1 *Cf.* the Report of the Royal Commission on Indian Curency and Finance, 1926, p. 33.

2 *Cf.* Dadachanji, *op. cit*, p. 69.

centres, as mentioned before, the indigenous bankers have associations according to the different castes to which they belong. But the associations have no touch with one another, and there is no organization for the exchange of information regarding the financial position of constituents, for the promotion and regulation of intershroff business, and for the adoption of a common policy and uniform methods of business.

The exchange banks have associations of their own at the principal port towns for keeping uniform standards in business transactions, and protecting the rights of members. But only foreign banks doing exchange business in India are their members. Further, there has been little co-operation between the Imperial Bank (now the State Bank) and the other banks. The Central Banking Committee, therefore, suggested the creation of an All-India Bankers' Association to include as members not only the Imperial Bank, exchange banks and Indian joint-stock banks but the indigenous bankers also.[1] The inclusion of the latter would be very helpful in bringing them into the fold of organized banking. Its membership should be of two kinds, full membership for all banks and bankers getting rediscounting facilities from the Reserve Bank, and associate membership for all the other banks and bankers. The Association would be very useful for discussing matters of common interest, deciding upon common action, carrying out reform and improvement of standards, removing elements of weakness, promoting the amalgamation of smaller banks, serving as an efficient connecting link between the members and the Reserve Bank and representing the needs, difficulties and grievances of members to Government. It should have branches at the important centres to deal with local problems, the central body disposing of matters affecting all the members as a body. The rapid expansion of banking resulting from the Second World War led some Bombay bankers to realize the necessity of forming an Association so as to be able to face the altered circumstances after the end of the war and to avoid or get over trouble. They have succeeded in overcoming the apathy and mutual jealousies of banks, and forming the Indian Banks' Association, with its head office in Bombay and local centres in Calcutta, Madras and Delhi. It is open to scheduled banks only. All the important Indian scheduled banks, with the exception of the State Bank, have jointed it. The committee on Finance

[1] See Report, p. 428.

for the Private Sector has recommended the establishment of an All-India Association of all banks for protecting the interests of banks, reaching agreements on matters of common interest, strengthening the banking system and developing the banking habit in the country.

11. *Clearing houses and their development.*—There are clearing houses at important centres in the country for simplifying and facilitating the daily exchange and settlement of debits and credits of banks. Their actual business is carried on in the offices of the Reserve Bank existing at certain centres and in the offices of the State Bank and its subsidiaries at the other centres, and the Banks provide the necessary supervision and staff. In many places where there is no clearing house, there is a system of clearing accounts by giving cheques on the State Bank in payment of balances due between the banks in the place. A bank can become a member of a clearing house by the consent of the existing members, and the State Bank has had no greater authority in the matter than any other member. New members are admitted after a close scrutiny of their balance-sheets by a committee of the existing members. Complaints were made to the Central Banking Committee that admission to a clearing house was severely restricted, and that Indian banks found it very difficult to secure admission, because the majority of its members were foreign banks.[1] The Managing Governor of the Imperial Bank, however, denied the complaints, and explained that heavy responsibilities were attached to the membership, that each application for the membership was dealt with on its own merits, and that even in England such membership was closely restricted, non-member banks doing their clearing through the 10 member banks.[2]

It is desirable that the clearing houses should be managed in all details in India, as in other countries, by incorporated associations of their members having their own regulations. Moreover, the supervision of all clearing houses is one of the functions of the Reserve Bank, and it investigates and removes legitimate complaints regarding their organization and working. Further, the Reserve Bank not only serves as the central clearing house for the country, but will also develop a system of collecting and clearing cheques throughout the country by promoting the

[1] See the statement of the Bengal National Chamber of Commerce, Central Committee Evidence, Vol. II, p. 499.

[2] See his answers, Central Committee Evidence, Vol. III p. 922.

creation of a net-work of clearing houses throughout the country under its supervision.

The total number of clearing houses functioning in the country in June 1962 was 69, of which 7 were managed by the Reserve Bank 54 by the State Bank, 7 by subsidiaries of the State Bank and 1 by a commercial bank.

12. *Methods of inland remittances.*—For financing the movement of crops and other purposes, funds are made available in different parts of the country by the following methods :—

(1) Remittances by means of hundis or cheques.

(2) Remittances through the Reserve Bank, State Bank and other joint-stock banks. The Reserve Bank issues and pays telegraphic transfers and bank-post bills. The State Bank purchases demand drafts and pays drafts and telegraphic transfers. The other joint-stock banks issue banker's drafts. The commission charged by all of them is small.

(3) Remittances through Government Treasuries. These sell to the public supply bills and transfers drawn upon other Treasuries, provided that the latter have sufficient funds for the purpose, and charge a small commission.

(4) Transfers of rupees and notes by railway or road. Although this method is being gradually replaced by the above methods, it is still popular.

(5) Postal remittances. Postal money orders are useful for remitting small sums, but expensive when large amounts are concerned. The charges should, therefore, be reduced. The post office has developed a system of setting payments in opposite directions against each other in the same way as cheques. Remittances by means of notes sent through registered or insured letters are still very popular.

These methods maintain the fluidity of money in different parts of the country to a substantial extent and reduce the differences in money rates.

Chapter XII

THE RESERVE BANK OF INDIA

1. *Many-sided need of it.*—All authorities have been unanimous in expressing the opinion that the most important step for removing many of the defects of the Indian banking and credit system, and securing its development on a sound basis, has been the establish-

ment of a Central Bank in India. We have seen in the previous chapter how the Bank has removed some of the defects and can remove others. The following are still other important defects for removing which the establishment of the Bank has been found necessary.

(1) The Reserve Bank has been found necessary for maintaining the purchasing power of the rupee stable internally and externally. Internal instability of the rupee on account of natural causes, such as the failure of the rains, or world causes, such as war or economic depression, may be unavoidable at present, although the international co-operation of the central banks will be helpful in dealing with such causes even. But internal instability caused by a maladjustment of the supply of, to the demand for, monetary circulation can be prevented by the Reserve Bank. The purchasing power of the rupee remains stable so long as the volume of the monetary circulation is adjusted to the amount of the media needed at any time for the exchange of the quantity of goods and services that have to be exchanged, taking into account the velocity of the circulation of the media and the frequency with which the goods and services are exchanged. The external stability of the rupee depends mainly upon its internal stability. If prices in India rise relatively to the world prices, India will be a better market in which to sell goods, but a worse one from which to buy them. This will stimulate imports and check exports, so that the balance of trade will become unfavourable, the exchange will be upset, and the internal depreciation of the rupee will soon lead to its external depreciation. The reverse will happen, if prices in India fall relatively to the world prices.[1]

The Reserve Bank can maintain this stability to a considerable extent, as it is given control over the volume of the monetary circulation in the country by means of the monopoly of the note issue and the power to impose on the country a judicious and appropriate credit policy. It can base its note issue partly on commercial bills which are self-liquidating assets, and the circulation will expand on the strength of the bills when they are drawn against trade transactions, and will contract when they mature and are liquidated.

The Reserve Bank can maintain the external stability of the

1 See the Report of the Royal Commission on Indian Currency and Finance, 1926, p. 46.

rupee to a considerable extent by buying sterling (or gold) from members of the public when they get it from abroad by way of the payments of claims due and wish to obtain currency in exchange for it, and by selling sterling (or gold) to them when they need it for making foreign payments of claims against them. Although the external stability of the rupee depends mainly upon its internal stability, the note issue must be backed in a substantial degree by assets which can deal with temporary disequilibria in the balance of foreign payments. Such disequilibria are sure to occur now and then owing to seasonal causes, a bad harvest, or internal or external financial stringency. At such times the balance of trade becomes unfavourable to India, and she has to pay other countries for it. Sterling and sterling securities (or gold) are the most useful assets for the purpose, and the Reserve Bank can use them quickly to pay the foreign liabilities until the adoption by it of an appropriate credit policy or the raising by it of the rate of discount corrects the disequilibria. The sale of sterling (or gold) by the Bank will lead to a contraction of the currency and a fall in prices, which will encourage exports and check imports and thereby tend to correct the disequilibria.

(2) The Reserve Bank has been found necessary for removing the structural instability of the banking system in India. Until 1935 the system had no solid basis, and was much liable to be upset by sudden demands for the withdrawal of funds or by financial crises. This vulnerability was due to the existence of the multiple reserve system, without the support of adequate cash reserves. Many of the Indian joint-stock banks conducted business of a magnitude not justified by their cash reserves and liquid assets. Considering their immense liabilities, it must be said that even the exchange banks made no adequate provision of cash reserves for runs or financial crises.

If a run takes place on a bank, its only way to restore the public confidence is to satisfy the demands of the depositors for the withdrawal of money fully and promptly. To be able to pursue this policy it must receive help from other banks, as the liquid assets of every bank are limited and if it does not receive help from other banks, these assets will soon get exhausted, and its position will become desperate. When one bank is exposed to a run, other banks are afraid to come to its rescue and to help it with cash, because the panic, like an infectious disease, may

spread to their depositors, and so they remain aloof and strengthen their own liquid resources. Moreover, in the absence of a co-ordinating agency, the banks, far from regarding their interests as common, are apt to consider one another as rivals, not deserving support in difficult times.[1] We have seen in the first chapter that these factors aggravated the banking crisis of 1913-17. Although from 1921 to 1935 the Imperial Bank of India served as a co-ordinating agency to some extent, it was not altogether a bankers' bank, as the other banks kept their reserves with it to a small extent only.

The creation of a single reserve system under the Reserve Bank removes these dangers. When the cash reserves of the other banks are pooled with that of the Reserve Bank so as to form a concentrated reserve in the hands of the latter, the insurance principle of distributing the risks of runs and similar emergencies comes into operation. The Reserve Bank can then occupy the position of an insurance company to which all banks contribute, so that no bank has to meet the entire risk, which is distributed among all the contributing banks.[2]

The concentrated reserve can be large enough to meet the needs of a bank fully and promptly in an emergency. Even if a run is made on several banks, such a reserve is more effective in making payments. Further, the Reserve Bank can use it, without paying it out, by making it the basis of the issue of additional notes, or of the grant of more credit. Moreover,the knowledge that the Reserve Bank possesses adequate cash reserves will quickly restore the public confidence, and will minimise the intensity of the panic, and the demand for cash except what is needed for the demands of foreign trade.[3] The Reserve Bank in virtue of its position as the custodian of the banking reserve of the country can also impose a prudent credit policy on the other banks, and thus mitigate the intensity of the panic, and give them more strength to meet it.

A second advantage of the single reserve system under the Reserve Bank, is its mobility. Money can be moved quickly from a centre where it is abundant to another where it is scarce. This is not possible when the reserves are scattered and managed independently by different banks. A third advantage of the

[1] *Cf.* Dadachanji, *A Reserve Bank for India and the Money Market*, p. 61.

[2] *Cf.* Burgess, *The Reserve Bank and Money Market*, p. 26.

[3] *Cf.* Kemmerer, *The A.B.C. of the Federal Reserve System*, p. 39.

system is its elasticity. The need of the other banks for funds in an emergency can be met by loans from the Reserve Bank. These loans will lead to the creation of more deposits or the issue of additional notes by the Reserve Bank, which will have to keep only a certain percentage of cash reserve against these liabilities. The Bank, therefore, can lend to the other banks at least twice as much as the value of the cash reserve, without overstepping the normal limit of the percentage of the cash reserve to its liabilities laid down by law; and it can lend much more in an acute emergency, if the borrowing banks can furnish the necessary security and are prepared to pay an increasing price for the accommodation, by overstepping the normal limit of the cash reserve, subject to the payment of a graduated tax as provided by law.

Finally, owing to its greater efficiency, a centralized reserve need not be as large as the total of the scattered reserves. The single reserve system, therefore, sets free a large amount of capital, which the banks can use to extend their business with profit to themselves, and the business community.[1]

In the countries of Europe, the amount of the balances which the other banks keep with their respective Central Banks is not regulated by statute, but is determined by an agreement between them, as the number of banks is comparatively small, and some concentration of reserves had already been in existence. In the U.S.A., however, the amount of the balances is regulated by law as a certain minimum percentage of the demand and time liabilities of banks. In India, regulation by statute has been regarded necessary, as seen below, although the number of banks is small, in order to strengthen the position of the Reserve Bank and to enable it to fulfil adequately its duties as a bankers' bank. The reason is that the foundations of the banking system in India are unstable at present on account of the lack of the banking habit among the people, and the indifference of the banks towards one another caused by the division of banking functions among them.

(3) The Reserve Bank has been found necessary to carry out a judicious and appropriate credit policy, which keeps the volume of currency and credit in proper adjustment with the volume of business, as well as the reserve, so as to maintain the stability of the value of the monetary unit, and to prevent instability and

[1] See Dadachanji, *op. cit.*, p. 65.

uncertainty in the money market and business of the country. For this purpose, firstly, the Reserve Bank is given the monopoly of the issue of notes which are the most important media of exchange and the cash basis for credit expansion. Secondly, member banks are compelled by the Reserve Bank Act to maintion a proportion of their liabilities as deposits with it. Thirdly, the holding of Government balances and the carrying out of the banking transactions of Government are useful to it for influencing the credit situation. Fourthly, an important instrument for carrying out the credit policy is the bank rate of discount, *i.e.* the Reserve Bank's official minimum rate for discounting first-class bills. The raising or lowering of this rate, by bringing about a similar rise or fall in the market rate, *i.e.* the rate at which the other banks lend money and discount bills, will enable the Reserve Bank to control the money market satisfactorily. Fifthly, a provision in the Reserve Bank Act empowers the Reserve Bank to resort to open market operations, *i.e.* to deal directly with the public in order to enforce its discount policy on member banks. If a lowering of the Reserve Bank rate is not immediately followed by a fall in the market lending rates, the Bank can lend direct to the people who wish to borrow funds, or purchase securities from them and thereby compel the member banks to lower their rates, to avoid losing business. Similarly, if a raising of the Reserve Bank rate is not immediately followed by a rise in the market lending rates, the Reserve Bank may borrow money from the public or sell securities to it and thereby compel the member banks to resort to the Reserve Bank for rediscounting their bills in order to replenish their low cash balances.

Finally, the establishment and management of a central clearing house by the Reserve Bank also enable it to control the working of the other banks. Admission to the clearing house as a member is a vary valuable privilege to the other banks, as it gives them a first-class status and enables them to present their claims against each other with the utmost despatch, and the Reserve Bank can make the membershp conditional upon their obedience to its instructions regarding the nature of their business and the credit of their customers. Moreover, if a bank expands its credit unduly, the Reserve Bank can detect it in the clearing house through the demands for settlement that will be made upon that bank by the other banks. The effectiveness of all these measures will be examined in a later section.

(4) It is an important function of the Reserve Bank to arrange for the compilation of proper and extensive statistics regarding the working of banks and indigenous bankers, and operations in the money market, and their prompt publication. Government co-operates with it in carrying out this function. The position in this respect was very unsatisfactory until recently. The exchange banks did not publish separately any statistics regarding their business in India, and merely supplied, out of courtesy, consolidated figures of their Indian deposits and cash balances lumped together for all the banks, belonging to each of the two classes mentioned in Chapter VIII, to the Director-General, Commercial Intelligence, Calcutta, through the India Office. Even as regards Indian joint-stock banks, the Director-General's publication *Statistical Tables relating to Banks in India*, did not supply sufficiently detailed figures, and gave no information at all relating to banks whose capital and reserve were less than Rs. 1 lakh. Moreover, the value of such statistics as were supplied was much reduced by the excessive delay that always took place in publishing them. The Reserve Bank now publishes the *Statistical Tables* with fair promptness. They give more information about Indian banks and separate information about each exchange bank. But no statistics are available regarding the operations of the indigenous bankers. The Reserve Bank also publishes annually *Statistical Tables relating to the co-operative movement in India*. Further, the Reserve Bank publishes annually *Trend and Progress of Banking in India* which gives very useful information regarding Indian and Exchange Banks.

(5) The Reserve Bank benefits Government directly by acting as its fiscal agent. The Bank promotes the success of Government loans and short-dated treasury bills, by suggesting to Government the proper time and terms for their issue, when the money market is easy and the banks have surplus funds awaiting investment, as it is in the closest contact with the money market, and by exerting its influence on banks and other investors to induce them to subscribe to the issues, and by giving them facilities for this purpose. By cautioning Government against such issues at a time when the money market shows a tendency to tightness and higher rates, it can not only protect the interests of Government, but also prevent an increase in the tightness and rates on this account, with consequent benefit to the business community.

The Reserve Bank also conducts remittance operations on behalf of Government that are necessary for making payments abroad. For paying the Home Charges in London, the Secretary of State used to sell Council Bills and Telegraphic Transfers in London to the exchange banks which were paid in rupees in India by the Government of India; but from 1923 up to 1936 the Government of India operated directly in the exchange market by purchasing sterling in India, by public tender or privately, from the exchange banks through the Imperial Bank. The latter method was preferable, because it was in India that bills were drawn for India's surplus of exports over imports of goods and that the liability of making the remittances arose, and because the Government of India knew much better than the Secretary of State, its own day to day cash position, the conditions of the money market in India, and the other factors influencing the course of exchange.[1]

But as Government remittances formed a large proportion of the total remittance business of India, these operations of Government produced a considerable influence on the money and exchange markets in India and India's currency system.[2] As the Reserve Bank is made responsible. for maintaining the stability of the value of Indian currency and for organizing and controlling the money market, it is essential for it to conduct the remittance operations on behalf of Government. So, since 1936, the Reserve Bank, on behalf of Government, purchases sterling in India from the exchange banks. The management, by the Bank, of these operations has done much to reduce their disturbing influence, as the Bank, possessing better knowledge of the conditions of the money and exchange markets than Government, can time them better, and conduct them more smoothly in normal times when the balance of trade is in India's favour. The remittance operations of the Bank are restricted to *bona fide* needs of its customers and the requirements of Government in respect of making payments abroad. If an Indian Exchange Bank is established, as recommended by certain members of the Central Banking Committee, and if Government remittances are handed over to it, the Reserve Bank will control the operations.

(6) The Reserve Bank can gradually bring about a great

[1] See Dadachanji, *op. cit.*, p. 138.

[2] See the Report of the Royal Commission on Indian Currency and Finance, 1926, p. 42.

improvement in the finance of agriculture. Through a special Agricultural Credit Department, the Bank can not only serve as an apex institution for co-ordinating the activities of the state co-operative banks, but can also provide the following valuable financial facilities for agriculture [1]:—

(i) The Bank can purchase, sell or rediscount bills of exchange or promissory notes drawn by co-operative societies for financing seasonal agricultural operations or the marketing of crops, and endorsed by a state co-operative bank.

(ii) It can grant advances at the time of cultivation against the promissory notes of co-operative societies, endorsed by a state co-operative bank, and giving a lien on crops. Endorsement by state co-operative banks and a limitation of the total amount of the advances will minimise the risk of granting advances not secured by the hypothecation of goods, and the Bank should undertake this much risk, if the cultivators, whose financial needs are the greatest at or just before the time of cultivation, are to obtain reasonable credit.

(iii) The Bank can allow the co-operative societies to draw upon the resources of the central money market buying the bankers' acceptances created by the societies.

(iv) The Bank can make a portion of the Government balances available to the state co-operative banks free from interest.

(v) Warehouses controlled by the Bank will be very useful to co-operative sale societies for stocking agricultural produce in them and obtaining credit cheaply and promptly against it.

(vi) The Bank, on account of its close contact with the money market, can render valuable help to state land mortgage corporations, the creation of which has been recommended before, to float debentures successfully, and at as low rates as possible, on behalf of agricultural land mortgage banks, when they are established in the States.

(7) The Reserve Bank can supply better credit facilities to agriculture and internal trade, make the supply of credit more elastic, and make its credit policy effective, by making use of those mofussil indigenous bankers, who are willing to be placed on its 'approved list' as its agents, wherever no branch of a bank exists or can exist owing to insufficient business. The qualifications for being put on this list should be the possession of a certain minimum of working capital and volume of banking business,

[1] See Dadachanji, *op. cit.*, p. 280.

restriction of activities to purely banking business, depositing a certain proportion of capitâl and deposits with the Reserve Bank, and periodical examination of accounts by the Reserve Bank. If one banker is unable to supply these qualifications, some of them can form associations for this purpose. The Reserve Bank can provide the agents with banking and agency business, and pay them commission, lend them money according to the business guaranteed by them, readily discount the hundis certified by them, and place them in charge of some of its godowns.

This connection with the Reserve Bank will strengthen the position and credit of the indigenous bankers, who in turn will provide an increasing number of hundis to the Reserve Bank. Further, they will gradually help the Reserve Bank to develop a bill market in India, to link up the country market with the city market, and to bring the former market also under its credit control, by forming themselves into Acceptance Associations, so as to increase the use of bankers' acceptances, which are the simplest and the most advantageous credit instrument for the needs of trade in India. The Reserve Bank should be given discretionary power to lay down the maximum rates within which the agents must lend their money and the Bank's money and to prevent them from using the latter money for their private business.

(8) No authoity other than the Reserve Bank can adequately perform the duty of watching the development of banking in this country and of taking steps to promote its advancement on the right lines in the interests of the nation as a whole.

The economic history of the great trading countries of the world during the last half century proves far more clearly than the above theoretical explanation the great efficiency of a Central Bank and its great influence upon the economic progress of a nation. Even the U.S.A. with her predilection for decentralization, was compelled to adopt a centralized banking system in 1913, as the frequent gigantic and disastrous financial upheavals in the country were attributed to the weakness of her decentralized banking system. The adoption of the Federal Reserve system has enabled her to build up the strongest position in the world of finance, next only to Great Britain.

2. *State Bank verses Shareholders' Bank, Reserve Bank nationalized in* 1949.—Realising this many-sided need for a Central Bank in India, the Central Legislature in India passed the Reserve

Bank of India Act in 1934 in accordance with the recommendations of a representative committee that had been set up in London, and the Reserve Bank of India started functioning from April 1935. Until 1st January 1949, it was a Shareholders' Bank, although a certain section of public opinion in the country and of the Central Legislature had expressed itself in favour of making it a State Bank, and of giving the Central Legislature the right to elect a proportion of the directors of the Bank from among its own members.

The arguments that were advanced to support the view that the Bank should have been a State Bank were as follows :—

(1) It would be dangerous to entrust the control over the very important functions of the Bank to private shareholders and their directors belonging largely to the capitalist class, as their interests would not always coincide with those of the people of India.

(2) The profit derived by the Bank from the the use of large public funds and from the issue and management of the nation's paper money should revert to the public treasury for the benefit of the country at large.

(3) The tradition of State ownership of large commercial undertakings of national importance had been firmly established in India. As regards railways for example, the people had an implicit faith in State management and were suspicious of private capitalistic ownership and control; and the State management of Indian railways had proved successful as a purely economic proposition.

(4) The very nature of the functions of the Reserve Bank, *viz.* central banking functions, including the management of currency, made Government control inevitable.

(5) Even in the countries which had Central Banks owned by shareholders, Government appointed the Governor and Deputy Governor, who exercised a preponderent voice in shaping the general policy of the banks.[1] Moreover, in practice it was Government which had the last word in shaping the policy.[2]

(6) The fear was expressed that a Shareholders' Bank would come under the predominant control of European business men

[1] See Kisch and Elkin, *Central Banks*, p. 57.

[2] *Cf.* Mr. Keynes' answer, Royal Commission on Indian Currency and Finance, 1926, Oral Evidence, Questions 13054-61.

and that, therefore, Indians would not receive a fair treatment from the Bank.

The reasons given for the demand that a proportion of the directors of the State Bank should be elected by the Central Legislature were as follows :—

(1) As the Executive was not responsible to the Legislature in India, the representatives of the people in the Legislature should have a voice in the directorate of the Bank, to ensure that the powers given to the Bank were exercised by it to promote the interests of the people in the best manner.

(2) To ask the Legislature to create the Bank and to make it responsible to the people for the good working of the Bank, without giving it any hand in the supervision or control over the working of the Bank, was constitutionally unsound.

The Reserve Bank of India, however, was made a Shareholders' Bank for the following reasons :—

(1) Twenty-two out of the twenty-eight Central Banks that existed at that time in different countries of the world were shareholders' banks, and even as regards the six that were State Banks, there were limitations on Government interference with their working.

(2) It was of fundamental importance that the Reserve Bank should be free to conduct its business on the lines of prudent finance, and in accordance with the provisions of the Act, which had brought it into existence, without being subjected to any political influence from Government or the Legislature. The function of raising and using money should be kept separate from the function of producing the actual tokens of money which were put into circulation. The largest user of money in a country was its Government, and when it wanted money to spend, it should have to raise the money by fair and honest means in the same way as a private individual. If Government controlled the Reserve Bank, which must be responsible for exercising the latter function, it might be tempted, as experience had abundantly shown from the time of the First World War, to abuse its powers and to compel the Bank to supply it money easily by using the note-printing press, especially if it was a democratic Government dependent upon the popular vote. It was essential therefore, that currency and credit operations should be in the hands of an authority independent of Government, and that there should not be even room for

suspicion of any intermixture of politics with the business of controlling currency and credit.

(3) The shareholders' plan had the merit of making the directors responsible for money which they themselves had contributed, and responsible to the shareholders for the money which the latter had contributed, and not responsible merely to their own consciences. The shareholders could exercise a decisive influence on the management of the Bank.[1]

(4) It had the further merit of providing a ready-made constituency wide enough to secure the representation of the whole country in the form of representative directors, capable, Indian in outlook, largely Indian in composition, fully conscious of their great responsibilities, and prepared to devote themselves wholeheartedly to the business of making the Bank successful.[2]

(5) It was unconstitutional for a legislature to take part in making appointments to special posts, as thereby it would overstep its proper functions and usurp those of the executive.

(6) If members of a legislature served as directors of the Bank, they would not have the time and energy required to attend adequately to their double duties, and they should decide to serve the country in the first capacity or in the second, but not in both.

(7) The fear of the predominance of capitalists over the Bank had been obviated by a wide distribution of the Bank's shares in the country and by a limitation of the voting rights attached to the shares.[3]

In February 1947, the Central Legislative Assembly passed a resolution favouring the nationalization of the Reserve Bank and in February 1948, the Finance Minister of the Government of India announced in the Constituent Assembly (Legislative) that his Government had decided to nationalize the Reserve Bank as soon as possible after 30th September 1948, when it would cease to be a common banker for India and Pakistan; and that Government would acquire the shares of the Reserve Bank at the average of the monthly market values of the shares from March 1947 to February 1948, taking the opening quotations for each month, and issue in lieu thereof to the shareholders 3 per cent. long-dated stock of equivalent value and appropriate maturity. Accordingly, the Nationalization of the Reserve

[1] *Cf.* Bhatter and Nemenyi, *The Reserve Bank of India and its Functions*, pp. 157-60.

[2] *Cf.* Dadachanji, *op.*, cit., pp. 326-7.

[3] See Legislative Assembly Debates, 1933, Vol. VI, No. 5, p. 1411, No. 8, 1526-7, Vol. VIII, No. 8, pp. 2417-8 and Vol. IX, No. 11, p. 3732.

Bank Act was passed in 1948 and the Bank was nationalized with effect from 1st January 1949. The shareholders were paid a value of Rs. 118 annas 10 in 3 per cent. long-dated stock per share. The shareholders complained that this value was too low and unjust because the period chosen for arriving at the proper value of the shares, *viz.* March 1947—February 1948, was abnormal on account of a heavy fall in the market value of equities and because many shareholders had purchased the shares from the market at substantially higher prices in the expectation of obtaining higher dividends calculated on the basis provided in Reserve Bank Act.

The necessity of nationalizing the Reserve Bank was open to doubt. Although in theory it was a shareholders' bank, in practice it was a State bank, because Government nominated its Governor and two Deputy Governors and four of the Directors of its Central Board and made sure that the Bank always co-operated with Government. In other countries, shareholders' Central Banks were nationalized either because a rift took place between the policies of the Central Banks and the respective Government or because the shareholders were obtaining high rates of dividends. Neither of these reasons operated in the case of the Reserve Bank of India. This Bank co-operated fully and always with the Government of India, even in its inflationary war finance and excessive extension of the cheap money policy.

At the same time, as an independent bank, in the country's interests, the Reserve Bank gave warnings to Government from time to time. It could not have done so, had it been a State Bank *i.e.* a department of the State. For instance, in 1943 it had warned Government of the dangers of accumulating sterling balances without any policy and had suggested that these assets should be used to the best advantage of the country by drawing up in advance a programme of reconstruction and that Government should concert safeguards for ensuring that these assets or equivalent foreign currencies would be available to India on a basis which would not involve a loss to it. Again, in 1944, it had advised Government to take steps to stop the export of essential commodities and to request the British Government to find rupee finance, as far as possible, for its expenditure in India, by the sale of bullion in India. Further, in 1945, it had suggested to Government that all disbursements of the British

Government in rupees should be paid for in free foreign currencies, or in capital or consumers' goods or in bullion. Yet again, in 1946, it had warned Government of the dangers of pushing the cheap money policy too far. The Reserve Bank also adopted whatever anti-inflationary measures it could.

Moreover, the Bank did not promote the interests of the shareholders at the expense of those of the nation. When the Bank of England and the Bank of France were shareholders' banks, they paid the shareholders as high a dividend as 12 per cent. But the Reserve Bank paid only 3½ per cent. during the first few years and 4 per cent. later, and paid the whole of the remaining portion of its huge profits into the Government treasury. While the shareholders, during the existence of the Bank as a shareholders' bank, obtained only a little more than Rs. 2½ crores by way of dividends, the Exchequer benefited by more than Rs. 80 crores. The Reserve Bank Act had provided for a gradual increase in the rate of dividends with the growing profits of the Bank, but Government made this provision inoperative by passing a rule under the Defence of India Rules.

The only reason for the nationalization of the Reserve Bank, therefore, appears to have been the enthusiasm of the new national Government of India for nationalization as a policy, in the early months of independence. A little later, this enthusiasm gradually petered out, and had not the Reserve Bank been actually nationalized in the early months of independence, it is probable that its nationalization would have been postponed for some years as was done in the case of the Imperial Bank of India.

The nationalization of the Reserve Bank has not meant any financial gain to Government, because the place of the very moderate dividend, amounting to Rs. 20 lakhs only annually, which had been given to the shareholders of the Bank, has been taken by the interest that has to be paid on the stock given to the shareholders. On the other hand, the nationalization has caused a loss to the nation, inasmuch as it has destroyed the independence of views and judgment of the Bank, as an expert institution. In the case of the nationalized Australian Commonwealth Bank and the Bank of England, independence of views and judgment has been provided for by means of legislation. The Banks have to inform their Governments of their views in monetary and banking matters from time to time; if there are

differences of opinion between the two, they are to be composed by mutual consultation as far as possible, and directions are to be given to the former by the latter only in the last resort. Similar maintenance of independence in the case of the Reserve Bank of India is difficult on account of the present political set-up of the country and the persons at the helm of the Bank and Government.

3. *Organization of the Reserve Bank under the Reserve Bank Act of* 1934.—The share capital of the Bank was Rs. 5 crores divided into fully paid-up shares of Rs. 100 each. Separate registers of shareholders were maintained at Bombay, Calcutta, Delhi and and Madras,[1] and the value of the shares originally assigned to the areas served by these registers was Rs. 140, 145, 115 and 70 lakhs respectively, but the shares were transferable from one register to another. A shareholder was registered as such in the area in which he was ordinarily resident or had his principal place of business, and had to be a person domiciled in India, or a British subject ordinarily resident in India, and domiciled in any part of the British Empire, the Government of which did not discriminate in any way against Indians, or a company registered under the Indian Companies Act, or a company incorporated under a law of any part of the British Empire, the Government of which did not discriminate in any way against Indians, and having a branch in British India.

The value of the shares applied for was many times the value of the shares assigned to each of the above areas. In allotting the shares the Central Board of the Bank had to give preference to applications for five shares each, so as to distribute the shares and the voting rights attached to them as widely as possible. The shares were quoted at a heavy premium on the stock exchanges from the beginning. The number of shareholders went on declining each year, and the number of shares in the Bombay and Calcutta areas increased at the expense of other areas, in spite of an amendment of the Reserve Bank Act limiting the number of shares held by an individual to 200.

The Bank has offices in Bombay, Calcutta, Delhi, Madras, Kanpur, Bangalore and London. It can have offices at other places in India and, with the previous sanction of the Government outside India. Its head office migrates from

[1] As the Reserve Bank ceased functioning in Burma from 1st April 1947, its Rangoon office was closed and its shares of the Rangoon register were transferred to the Madras register.

one office to another in India at the discretion of the Central Board, in order to secure balanced consideration of the varying interests of the different parts of the country. The general superintendence of the business of the Bank was entrusted to a Central Board of Directors consisting of—

(*a*) a Governor and two Deputy Governors[1] appointed by the Governor-General-in-Council after consideration of the recommendations made by the Board in that behalf;

(*b*) four Directors nominated by the Governor-General-in-Council;

(*c*) eight Directors (two each for the Bombay, Calcutta and Delhi registers and one each for the Madras and Rangoon registers) elected by the Local Boards from among themselves to represent the shareholders; and

(*d*) one Government official nominated by the Governor-General-in-Council.

The Deputy Governors and the Government official, however, were not entitled to vote. The Governor and Deputy Governors held office for such a term not exceeding five years as the Governor-General-in-Council might fix, and were eligible for re-appointment. Their salaries and allowances were determined by the Central Board with the approval of the Governor-General-in-Council. The other nominated Directors held office during the pleasure of the Governor-General-in-Council. The elected Directors held office for five years, and were eligible for re-election.

A Local Board for each of the areas assigned to the respective registers consisted of five members elected from among themselves by the shareholders registered in each area at least six months previously and holding at least five shares, and not more than three members nominated by the Central Board. Each shareholder had an additional vote for each additional five shares, subject to a maximum of ten votes. Fresh election or nomination of the members of each Local Board took place at any time determined by the Central Board within three months preceeding the date on which the Directors of the Central Board representing the shareholders were due to retire, but the outgoing members were eligible for re-election or re-nomination. A Local Board advised the Central Board on such matters as were referred to it, and performed such duties as were delegated to it by the Central Board by means of regulations.

1 It had only one Deputy Governor from 1937 to 1943.

No person could be a Director of the Central Board or a member of a Local Board, who—

(1) was a Government official or an official of an Indian State,

(2) or was or at any time had been, adjudicated an insolvent, or had suspended payment, or had compounded with his creditors,

(3) or was an employee of any bank, or was a director of any bank other than a co-operative bank,

(4) or did not hold unencumbered shares of the Bank of a nominal value of not less than Rs. 5,000 at any time after six months from the date of his nomination or election,

(5) or was a member of the Central Legislature or a Provincial Legislature in India.

The first and third restrictions, however, did not apply to the Governor, Deputy Governors and the official representing Government on the Central Board.

The Central Board met at least six times each year. The committee of the Central Board met 30 times a year. A general meeting of the shareholders was held annually within six weeks from the date on which the annual accounts of the Bank were closed, and additional general meetings could be convened by the Central Board at any other time.

4. *Organization of the Reserve Bank under the Reserve Bank Act (Nationalization) of* 1948.—Under this Act, the Central Board of Directors of the Reserve Bank now consists of (1) a Governor and two Deputy Governors, appointed by the Central Government, (2) four directors nominated by the Central Government, one from each of the four Local Boards, (3) six directors nominated by the Central Government to represent different interests and (4) one official of the Government.

Each Local Board consists of five directors nominated by the Central Government to represent territorial and economic interests as well as the interests of indigenous bankers and co-operative banks. The members of each Local Board elect a Chairman from among themselves.

The members of the Central and Local Boards hold office for four years.

The Central Government has the power to direct the Bank, after consulting the Governor, from time to time, in the interests of the public. Subject to such directions, the Bank has freedom in respect of general superintendence and general banking business, which are entrusted to the Central Board of Directors.

The Local Boards advise the Central Board on such matters as may be referred to them. The Finance Minister, during the debate on the Reserve Bank Bill, gave the assurance that the Government would not interfere at all in the internal administration of the Bank. The fear has, however, been expressed that Government will nominate only such persons on the Boards as can be depended upon to agree to its policies and that the nominated directors will not be able to express their views with the same freedom as the elected directors could do formerly.

5. *Functions of the Reserve Bank, as provided by the Reserve Bank Act.*[1]—*Issue of bank notes.* To give the Bank complete and uniform control over the currency and credit system of the country, it has been given the sole right to issue bank notes. This has been done also in the interests of the stability of paper currency, as the Bank is not actuated primarily by the desire to earn profits and is compelled by law to keep an adequate reserve. For the issue of notes, the Bank has to maintain a separate Issue Department, the assets of which must be kept separate from those of the Banking Department, and are not subject to any liability other than the liabilities of the Department in respect of the notes issued. The Department cannot issue bank notes to the Banking Department or to any one else, except in exchange for other bank notes, or for such coin, bullion or securities as are permitted by the Act to form a part of its reserve. The denominations of notes issued are Rs. 2, 5, 10, 100, 1000 and 10,000.[2] The denominations of 1,000 and 10,000 were withdrawn in 1946 but restored in 1954.

Every bank note is legal tender throughout India in payment for the amount stated therein, and is guaranteed by the Governor-General-in-Council, who may, however, declare by a notification in the Gazette of India that a particular series of bank notes will cease to be legal tender from a specified date, except at an office or agency of the Bank. If at any time the Bank fails to comply with any provisions of the Act, the Governor—General-in-Council may declare by a notification that the Bank has forfeited the right of note issue, and will thereupon take over the liabilities of the Issue Department together with such a portion of the assets of the Bank as will be required to meet these liabilities, and thereafter the business of the Issue Department will be carried on by

[1] For a fuller description of the functions, see *Functions and Working of the Reserve Bank of India,* published by the Reserve Bank.

[2] One rupee notes are issued by the Government of India.

such agency as the Governor-General-in-Council may determine. When he takes such action, he must report it fully to the Central Legislature within three months.

According to Section 33 of the Act, the assets of the Issue Department against which bank notes are issued are to consist of gold coin and bullion, foreign securities, rupee coin and Government of India rupee securities. The original Act prescribed a proportional reserve of gold and foreign securities against note issue, whereby, of the total assets, not less than 40 per cent was to consist of gold coin and bullion, and foreign securities, with the proviso that gold coin and gold bullion was at any time not to be less than forty crores of rupees in value. This requirement remained unchanged for over twenty years. Afterwards, the rapid progress in economic activity under the impetus of the development plans and the expansion in the monetized sector of the economy have called for a large expansion of currency. The financing of the Plans has also necessitated heavy drafts on the foreign reserves held by the Bank. Hence, the Reserve Bank of India (Amendment) Act of 1956 provided for substitution of the proportional reserve system by a minimum of foreign reserves in absolute amount *viz.*, Rs. 400 crores in foreign securities and Rs. 115 crores in gold coin and bullion or a total of Rs. 515 crores. Also, whereas previously gold held by the Bank was valued at the rate of 8.47512 grains per rupee or Rs. 21.24 per tola, the amending Act provided for the revaluation of gold at the official parity price agreed to by the International Monetary Fund, *i.e.* at the rate of 2.88 grains of fine gold per rupee or Rs. 62.50 per tola. The minimum reserve to be held in gold was fixed at Rs. 115 crores, instead of at Rs. 40 crores. The Reserve Bank of India (Second Amendment) Act, 1957 prescribed that the aggregate value of gold coin, gold bullion and foreign securities held in the Issue Department at any time should not be less than Rs. 200 crores; of this, the value of gold (bullion plus coin) should not be less than Rs. 115 crores in value, the same as before. As in other central bank statutes, provision has been made for suspension of the requirements regarding reserves of foreign exchange to meet unforeseen contingencies. The Second Amendment Act of 1957 empowers the Reserve Bank, with the previous sanction of the Central Government, to dispense with holding foreign securities at all; it must, however, have gold equivalent to Rs. 115 crores.

(*b*) *Supply of currency and coin.*—The Bank is obliged to convert its notes into notes of lower value or other legal tender

coin in such quantities as in its opinion are needed for circulation, and to issue rupee coin on demand in exchange for notes, and notes in exchange for legal tender coin. One rupee notes issued by the Government of India now constitute legal tender coin.

(c) *Sale and purchase of sterling and other foreign currencies.*—An important central banking function performed by the Reserve Bank is that of maintaining the external value of the rupee and for this purpose the Bank holds most of the nation's foreign exchange reserves. 70, 10 and 20 percent. of India's total external transactions are financed in sterling, doller and other currencies respectively. This heavy reliance on sterling for financing India's international transactions and the facilities for finance available in the London market have made it desirable to continue the link of the rupee with the pound sterling. The rupee-sterling ratio was fixed at 1s. 6d. per rupee in 1927 and it has been maintained since then.

The Bank buys both spot and forward sterling, of a value not less than Rs. 2 lakhs, for a period up to six months, from scheduled banks authorized to deal in foreign exchange at 1s. 6d. It sells sterling at 1s. 5 63/64d., the rate for forward sterling being lower by 1/64d. per rupee. The narrow margin between the Banks' buying and selling rates for spot sterling and its provision of forward cover at a very low rate enable the scheduled banks, recognised as authorized dealers to convert rupees into sterling and *vice versa* and to meet the requirements of the public for sale or purchase of sterling at fine rates, thereby maintaining the stability of the external value of the rupee. The buying and selling rates of scheduled banks for sterling, for transactions with the public, are fixed in conformity with these rates by the Foreign Exchange Dealers Association of India in consultation with the Reserve Bank.

Only a small proportion of India's external transaction are financed in currencies other than sterling. The unrestricted convertibility of these currencies within the sterling area resulting from the support given by the various central banks at levels near parity enables the authorized dealers in India to obtain cover for them at fine rates either in London or in the sterling area centre concerned. The Exchange rates in India for non-sterling area currencies are generally determined by the rates in London. Authorized dealers obtain their current requirements and forward cover for non-sterling area currencies in the London exchange

market or from banks in the monetary area, whose currency they wish to buy or sell. The rates quoted by the authorised dealers in India are in step with the rates in overseas centres.

India is a member of the group of countries known as 'sterling area' with Great Britain as the centre country. Its chief features are the maintenance of a large portion of the monetary reserves of the member countries in sterling, the maintenance of exchange parity of the domestic currency with sterling through operations in spot and forward sterling and pooling of currencies of non-sterling area countries, particularly the U. S. and Canadian dollars. At the commencement of the Second World War, the foreign assets of the Reserve Bank, which constitute the main reserves of the country, amounted to Rs. 152 crores. By the end of the war, they rose to Rs. 1,422 crores on account of large balance of payments surpluses resulting chiefly from India's contribution of goods and services to the Allied war effort. On account of the Partition, various agreements concluded with Great Britain for purchase of defence stores and pension annuities and drawing for meeting balance of payment deficits, the foreign assets of the Bank fell to Rs. 97 crores by July 1962, besides the gold reserve valued at Rs. 118 crores.

(d) *Banker to Government.*—The Bank must accept money for the account of the Union and State Governments in India, make payments on their behalf, carry out their exchange, remittance and other banking operations, and manage the public debt. The Union and State Governments in turn must entrust the Bank with all their money, remittance, exchange and banking transactions in India, the management of the public debt and the issue of new loans in India, and deposit free from interest all their cash balance with the Bank. But these Governments are free to carry on money transactions at Government treasuries or sub-treasuries, at places where the Bank has no branches, or agencies in the shape of the branches of the State Bank, and to hold at them such balances as they may require. The Reserve Bank is not entitled to any remuneration, other than the holding of Government cash balances free of interest. But under agreements with the Bank, State Governments have to keep with it such minimum balances as may be agreed upon between them and the Bank. They have to meet any temporary deficits in these minimum balances either by issuing their own treasury bills or by obtaining ways

and means advances from the Bank, at a rate not exceeding the bank rate. The advances must be repaid within three months. The rupee loans of the Union and State Governments are floated through the Public Debt Office of the Bank, in amounts, on terms and at times settled by them in consultation with the Bank. As remuneration for the management of the public debt, it receives half-yearly a commission of Rs. 1,000 per crore of rupees of the debt.

The Bank has to keep currency chests at Government treasuries and sub-treasuries, its own offices and agencies, numbering about 1,300, and to keep the chests supplied with sufficient notes and coin to provide currency for the transactions of Government, and reasonable remittance facilities to banks and the public at low rates.

The Union Government resorts to short-term borrowing in the shape of treasury bills issued for 3 months. They are sold through the offices of the Reserve Bank either by tender or at an intermediate tap rate. If tenders received are in excess of the amount offered, a proportionate allotment is made, the minimum allotment being Rs. 25,000. When the Government requires accommodation for a shorter period, it obtains ways and means advances from the Bank at one per cent. below the bank rate. The advances are repayable not later than 3 months from the date of making them. The State Governments also can obtain them. Since 1954 the Union Government has resorted to the Bank for accommodation on an increasing scale to meet the growing development expenditure under the Five-Year Plans, but this has taken the form of sales of ad hoc treasury bills to the Bank rather than ways and means advances. Since 1950, there have been no sales of State Government treasury bills.

The Bank renders considerable assistance to the High Commission of India in the United Kingdom, which has been the Central Government's chief procurement and financial agency abroad. In recent years, the scope of the Commission's operations has been enlarged on account of the purchase of plant, machinery, etc., which it makes abroad in connection with the projects undertaken by the Central and State Governments and other quasi-Government bodies. For meeting the expenditure on these purchases as well as the establishment charges of our embassies in Europe, sterling exchange is sold to Government by the Bank by a debit to its rupee account with the Bank and placed as a deposit at the London office of the Bank. The funds so

deposited with the London office are drawn upon by the High Commission for meeting all payments for imports on Government account and other purposes. The services provided by the London office also include purchase of dollers and other non-sterling currencies in the London foreign exchange market for remittance to the India Supply Mission, Washington and Indian diplomatic missions abroad. Where suppliers of goods to Government so require, arrangements are made by the London office for issue of letters of credit and guarantees.

The Bank's advice is frequently obtained by Governments in connection with the issue of new loans, conversions of old ones, investment of funds, agricultural credit, co-operation, banking and credit legislation, etc. It co-ordinates the borrowing programmes of the Union and State Governments, in order to remove uneconomic competition between them. It also facilitates the floatation of the loans of States Governments, by underwriting them with the help of the large scheduled banks and sharebrokers. It minimises the effects of Government borrowing operations on trade and industry, and at the same time secures the best possible terms for the borrowing Governments.

(*e*) *A Bankers' Bank.*—The Reserve Bank has been given this position to enable it to regulate the credit and banking system of the country. The Union Government directs the inclusion, in the second schedule under the Act, of every company legally incorporated in or outside India, so long as it carries on banking business in India, and has a paid-up capital and reserve of the real or exchangeable value, and not merely the book value shown in the balance-sheet, of Rs. 5 lakhs, as determined by the Reserve Bank, after inspecting, if necessary, the applying bank's books. The inclusion of a bank in the schedule gives no continuing guarantee of its soundness or stability. Its fitness to be retained in the schedule can be tested by the Reserve Bank at Government instance, and if its capital and reserve are found to have fallen below the prescribed minimum, or if it ceases to carry on banking business, it will be removed from the schedule. In 1961, there were 83 scheduled banks with 4388 branches. They form a heterogeneous group, consisting of the State Bank, the State Subsidiary Banks, the 16 Exchange banks, the 'Big seven,' Indian banks, and others with smaller paid-up capital and reserves.

Each scheduled bank has to maintain with the Reserve Bank a balance not less than 3 per cent. of its demand and time liabilities.

This balance is inadequate to guarantee the deposits. Its object is to enable the Reserve Bank to exercise some control over the banking system. Every scheduled bank has to send to the Union Government and the Reserve Bank a weekly return (monthly, if the Bank decides that a weekly return is not practicable owing to the geographical position of a bank and its branches) of its position in the prescribed form. The Reserve Bank is required to publish a consolidated statement of these returns, as it is a very useful guide to the money conditions in the country. Failure to submit a return makes a bank liable to a penalty of Rs. 100 per day of failure. If it fails to maintain the minimum balance, it has to pay penal interest at prescribed rates to the Reserve Bank, and is prohibited from accepting fresh deposits during the period of default, and its directors and officers are fined, if they are knowingly parties to the default.

In return for these restrictions, a scheduled bank has the facility of financial assistance from the Reserve Bank in the shape of rediscount of eligible bills, or loans and advances against eligible securities. To promote the development of sound banking, the Reserve Bank, in granting credit, takes into account not only the nature of the security offered to it, but also the general condition of the bank applying for aid, and the manner of its total business, whether it pays unduly high rates of interest on deposits, or applies for help from the Reserve Bank, even when money conditions are very easy, or has been indulging in over trading or in unsecured business excessively, or granting excessive credit for speculation in commodities and securities. To prevent misuse of its credit facilities, the Reserve Bank can call for such information, or impose such conditions on the applying bank, as it may think necessary. It may also refuse to rediscount the paper of any scheduled bank, without giving a reason. But properly managed scheduled banks can always depend upon accommodation from the Reserve Bank, during periods of stringency or emergency, provided they offer satisfactory security.

(1) *Discounts for, and advances to, scheduled banks.*

(i) The Act authorizes the Reserve Bank to purchase, sell and rediscount bills of exchange and promissory notes payable in India and arising out of *bona fide* commercial transactions, bearing two or more good signatures, one of which must be that of a scheduled bank, and maturing within 90 days, i.e. time and not demand bills or notes. The scheduled bank concerned

has, therefore, to supply the Reserve Bank with information regarding the credit standing of the persons, from whom it obtains these bills, the nature of the business in which they are engaged and for which each bill is drawn, and their other liabilities, and the Reserve Bank may also make a separate enquiry regarding the persons, so that it may be sure of the soundness of the security and the nature of the transactions. Banks can make promissory notes acceptable to the Reserve Bank for rediscount by changing them into time ones, if they are demand ones, as the stamp duty has been reduced, and by drawing them to finance definite business transactions.

(ii) The Act authorizes the Reserve Bank to purchase, sell or rediscount agricultural bills or promissory notes, which are payable in India, bear two or more good signatures, one of which must be that of a scheduled bank or a state co-operative bank, are issued for financing seasonal agricultural operations or the marketing of crops, and mature within 9 months from the date of purchase or rediscount by the Reserve Bank. Hence, the state co-operative bank offering bills for rediscount, and the central co-operative bank, or marketing or warehousing society, whose second signature appears on them, must be financially sound. As some of the state co-operative banks have been working on low cash balances, the Reserve Bank has informed all of them that they should maintain with the Bank 1 and 2½ per cent. of their time and demand liabilities respectively. Morover, the bills and notes must not be payable on demand, and must not contain conditions, such as penal interest in the case of default, repayment of the loan earlier under certain conditions, etc.

(iii) The Act authorizes the Reserve Bank to purchase, sell and rediscount bills and promissory notes drawn in India for holding or trading in Government securities, bearing the signature of a scheduled bank and maturing within 90 days. But this provision has remained inoperative on account of the absence of a bill market to finance dealings in Government securities.

(iv) The Act authorizes the Reserve Bank to purchase, sell or rediscount bills of exchange, including treasury bills, drawn in or on any place in the United Kingdom, and maturing within 90 days, provided that no such purchase, sale or rediscount is made in India, except with a scheduled bank.

The Act authorizes the Reserve Bank to make to scheduled banks loans and advances, repayable on demand, or on the expiry of fixed periods not exceeding 90 days against the security of (*a*) stocks, funds and securities in which a trustee is authorized to invest trust money by the Trust law, (*b*) gold or silver or documents of title to the same, (*c*) such bills of exchange and promissory notes as are eligible for purchase or rediscount by the Reserve Bank, and (*d*) promissory notes of any scheduled bank or state co-operative bank, supported by documents of title to goods, which have been transferred or pledged to the bank as security, for a cash credit granted for *bona fide* commercial transactions, or for the purpose of financing seasonal agricultural operations or the marketing of crops. As regards (*a*) and (*b*),the Reserve Bank must keep a sufficient margin, and as regards (*a*) it must further see that the securities are readily marketable.

(2) *Remittance facilities to banks.* A scheduled bank can remit money as follows :—

(*a*) Rs. 10,000 or multiples thereof, between its accounts at the offices of the Reserve Bank, free of charge.

(*b*) Thrice a week Rs. 5,000 or multiples thereof, to any of its account with the Reserve Bank, from any place at which it has an office and at which the Reserve Bank has an agency, free of charge. Similar facility in the reverse direction *i.e.* from its accounts maintained with the offices of the Reserve Bank to its branches at upcountry centres where there are branches of the State Bank or its subsidiaries performing agency functions.

(*c*) Other remittances to any of its accounts, subject to a charge of 1/64 per cent.

(*d*) Other remittances between accounts maintained at the Reserve Bank or its agencies, up to Rs. 5,000, 1/32 per cent. and over, 1/64 per cent. In addition, telegraphic transfers and drafts in favour of third parties are issued, subject to the limits on drawings on treasury agencies, at the rates mentioned under (*d*) above.

The poor capital structure of non-scheduled banks is seen from the fact that out of 222 of them, 60 have paid-up capital and reserve below Rs. 1 lakh. Nevertheless, the Reserve Bank gives the same remittance facilities, as mentioned above, which are given to scheduled banks, to those non-scheduled banks

which are registered under the Indian Companies Act, transact banking business in India as defined in the Banking Companies Act, have a minimum paid-up capital of Rs. 50,000 and apply to the Reserve Bank for inclusion in the approved list. Further, the Reserve Bank gives the same remittance facilities to state co-operative banks and their affiliated central or industrial co-operative banks and indigenous bankers, defined as persons or firms who accept deposits and/or discount hundis with joint stock and other banks with a view to making loans, own a minimum capital of Rs. 50,000 and are included in the approved list.

(3) *Inspection and Licensing of Banks.*—In pursuance of the responsibilities devolving upon it under the Banking Companies Act 1949, the Reserve Bank has instituted systematic periodic inspection of all banking companies governed by the Act. The first round of inspection of all scheduled and non-scheduled banks was completed in 1953 and 1955 respectively. Simultaneously, re-inspections of banks were also undertaken whenever the progress reports submitted by them after the first inspection indicated the need for such re-examination. The defects revealed by the inspection are brought to the notice of the banks concerned by the Reserve Bank and advice is tendered on ways and means of remedying them. If re-inspection reveals their continuance, specific comments of the banks concerned are invited thereon. As at the end of 1957, monthly progress reports were called for from 242 banks and quarterly reports from 93 banks. At the end of June 1962, they were called for from 92 and 147 banks respectively. They are carefully scrutinized. In cases where the findings warranted stricter control over the affairs of the banks concerned, suitable conditions have been imposed. Where the management of a bank needed constant guidance, the appointment of a banking adviser has been insisted upon. In addition, in certain cases, officers were deputed by the Reserve Bank for attending the board or committee meetings of the banks concerned as observers and for carrying out periodical scrutiny of their affairs.

The utility of the above inspections is borne out by the progress, although gradual, made by banks in eradicating several defects observed in their working and in developing sound banking practices. However, some of the important defects revealed by the earlier inspections still persist, particularly among the small-

sized banks. Some of the more important defects are inadequacy of reserves and liquid assets, the high proportion of advances in relation to resources, the relatively large volume of unsecured advances and advances against immovable property, the concentration of advances in the hands of a few borrowers and the low level of investments in Government securities. While several of the banks have been able to rectify the procedural and organizational defects in a reasonable time, very few of them have been able to show appreciable progress in the correction of operational defects. In this context, it may be stated, that the banks plead that some of the defects, such as sticky advances, clear advances and advances against immovable property are by their very nature difficult to rectify within a short period. The refusal of licence to carry on banking business has been resorted to by the Reserve Bank only in the cases of those banks, whose position was found to be beyond repair. The Reserve Bank has taken in hand the work of licensing of banks side by side with their inspection. By June 1962, licences were granted to 65 scheduled banks and one non-scheduled bank for carrying on banking business in India.

These 65 banks together with the State Bank of India and eight State-associated banks, which did not require a licence, accounted for deposit resources of over 96 per cent. of total deposits of all banks in the country. 145 non-scheduled banks were refused licences by June 1962, as their affairs were being conducted in a manner detrimental to the interests of their depositors. The applications of 232 banks were pending at the end of June 1962. The slow progress in the licensing of banks is due principally to the Reserve Bank's anxiety to safeguard the interests of the depositors and at the same time to give as many banks as possible a fair chance to qualify for a licence. Unfortunately, banks have been rather tardy in taking steps to rectify the defects in their operations, which alone would facilitate the grant of licences to them.

(4) *Amalgamation of Banks.* While, under the Banking Companies Act, schemes of amalgamation cannot be put through without the sanction of the Reserve Bank, the Bank had no power until 1961, to compel banking companies to amalgamate. It could only tender advice and consider any proposals that were placed before it. It gave such advice for consolidating the position of those banks which were in need of improving their stability and efficiency. In cases where amalgamations were not con-

sidered desirable, it advised banks to arrive at mutually agreed arrangements for the transfer of liabilities and assets. The Banking Companies (Amendment) Act, 1961 has given it powers to compel banks to amalgamate and the use of these powers by it has been explained in Chaper I.

(5) *Action regarding lending policy of Banks*—. The Reserve Bank has taken various measures to ensure that the pattern of bank credit conforms to the general economic policy and to the needs of the situation in the country. Thus, at certain times, the Reserve Bank has required all scheduled banks to furnish returns of credit limits for Rs. 1 lakh and over sanctioned by them or statements showing their advances against bullion and commodities which were the object of speculative interest. The Reserve Bank has scrutinized them and whenever it was found that bank finance was being utilized for speculative building up of stocks, has taken appropriate measures, such as requesting banks to recall their advances granted for certain purposes or to go slow in the matter of such advances and to see that such advances would not be used for speculative purposes or to limit their advances against certain commodities to particular levels and to increase the margins. On the other hand, the Reserve Bank has taken measures to facilitate extension of bank advances for certain special purposes, such as giving an assurance to banks in 1952 that it would grant them reasonable facilities for the financing of the purchase of Indian and imported cotton and suggesting to banks in the same year that they should provide additional finance to sugar mills and tea gardens. Since 1957, it has issued various directives to banks, imposing general or selective credit controls, from time to time, according to the needs of the situation in the country. They are explained later.

(6) *Extension of Banking Facilities*—. In view of the predominantly agricultural nature of the Indian economy and the relative paucity of agencies for provision of rural finance, the bias in this side of the Reserve Bank's activities has been on development of commercial and co-operative banking in the rural and semi-urban areas along the lines recommended by the Rural Banking Enquiry Committee (1950) for provision of better facilities, including cheaper remittance, to both commercial and co-operative banks operating in the villages and towns.

Besides the special arrangement for the opening of a number of branches of the Imperial Bank up to 1st July 1955 and later

of the State Bank, the Reserve Bank has adopted several measures to enable commercial banks to establish branches in outlying areas and co-opérative banks to increase the size of their operations. The Reserve Bank has been granting readily licences to banks for opening branches in those places in which banking facilities were absent or inadequate. Moreover, it has sought to promote banking development through liberalization of remittance facilities. The Rural Banking Enquiry Committee had recommended that a lowering of rates on remittances would reduce the cost of operation of branches of banks and would encourage their establishment. The Committee was also of the opinion that such a measure would contribute to a quicker adjustment between the supply of and demand for funds in the metropolitan as well as mofussil centres. Accordingly, from September 1951 the Reserve Bank reduced the rates of exchange on remittances issued on behalf of commercial banks, co-operative banks and societies and indigenous bankers from its offices and agencies, including treasury agencies. The existing rates have been mentioned before.

At the same time, the Reserve Bank has been making efforts to increase the availability of finance to industrial and urban sectors and to build up an integrated credit mechanism that would suit the requirements of a developing economy.

(7) *Training Facilities*—. The Reserve Bank established a Bankers' Training College in 1954 to impart training in practical banking to the supervisory staff of commercial banks in the country. The curriculum of the College is so designed as to be of maximum advantage to the branch manager of the average-sized branch of a commercial bank. The facilities afforded by the College and their beneficial effects on individual trainees have been increasingly appreciated by banks.

The Reserve Bank subsidizes the Co-operative Training College, which was established in Poona in 1952 by the Bombay Provincial Co-operative Institute. This College provides training to the higher staff of the Co-operative institutions and departments. For the training of their intermediate personnel, five regional centres have been established at different places in the country.

(f) *The Reserve Bank's help to agriculture.*—As the supply of finance to agriculture is the most important and yet the most difficult of the problems of Indian banking, the Reserve Bank Act makes the resources of the Bank available to agriculture

within limits imposed by strict adherence to central banking principles. Thus, as mentioned before in (*ii*) of discounts for scheduled banks, the Reserve Bank is authorized to purchase, sell or rediscount agricultural paper. Further, it is authorized to give loans and advances, for periods not exceeding 90 days, to state co-operative banks against (*i*) Government securities subject to limits and margins, (*ii*) approved debentures oJ recognized land mortgage banks, which are declared trustee securities and are readily marketable, (*iii*) promissory notes of approved co-operative marketing or warehouse societies, endorsed by state co-operative banks, and drawn for the marketing of crops, (*iv*) promissory notes of state co-operative banks, secured by warehouse warrants, issued by corporations independent of the borrower, and (*v*) promissory notes of central co-operative banks, endorsed by state co-operative banks, and drawn for financing seasonal agricultural operations or the marketing of crops. As a pre-condition of obtaining the above accommodation, the state co-operative banks have to maintain with the Reserve Bank an amount not less than 2½ and 1 per cent. of their demand and time liabilities respectively and to get their books and accounts inspected by the Reserve Bank.

Finally, the Reserve Bank is authorized to rediscount the promissory notes mentioned in (*iii*), (*iv*) and (*v*) above, if they mature within 9 months, and to discount treasury bills purchased by the state co-operative banks.

Financial accommodation to the co-operative movement is granted by the Reserve Bank through apex-co-operative banks at a concessional rate of 2 per cent. below the bank rate for financing seasonal agricultural operations and the marketing of crops. Until recently, however, this facility was not used extensively by the co-operative banks for various reasons. Consequently, the Reserve Bank has introduced various procedural reforms in the provision of this accommodation. As a result of this as well as of the remittance and other facilities made available by the Reserve Bank to co-operative banks along with commercial banks, a considerable increase has taken place recently in the extent of loans granted by it to the co-operative movement. The credit limits sanctioned by the Reserve Bank to co-operative banks for financing seasonal agricultural operations and the marketing of crops amounted to Rs. 7 lakhs only during 1946-47. Then they went on increasing and stood at Rs. 21.21, 29.64 and 35.25 crores during

1954-55, 55-56 and 56-57 for 15, 19 and 17 state co-operative banks respectively. They stood at Rs. 114.8 crores in June 1962 for 18 state co-operative banks. With the amendments to the Reserve Bank of India Act in 1951 and 1953, the foundations of the Reserve Bank in the sphere of rural credit have been further enlarged. The amending Acts extend the scope of the expressions 'seasonal agricultural operations' and 'the marketing of crops' to include mixed farming activities and the processing of crops by agriculturists or their organizations. The period of short-term accommodation has been extended to fifteen months and the Bank is empowered to grant medium-term loans upto a maximum period of five years.

Accordingly, the Reserve Bank has been giving loans for periods of three years at a rate which was 2 per cent. below the bank rate upto November 1960, and which is 1½ per cent. below the bank rate since then, in order to minimise the use of these medium term loans for short-term purposes. The guarantee of the respective State Governments and promissory notes executed by the borrowing co-operative banks are the security for the loans. The purposes for which they can be granted are the reclamation of land, bunding and other land improvements, purchase of live stock, implements and machinery required for agriculture and the construction of farm houses and cattle sheds. During 1954-55, 55-56 and 56-57 the Reserve Bank sanctioned medium-term loans amounting to Rs. 1.22, 1.40 and 1.67 crores to 4,10 and 6 state co-operative banks respectively. By June 1962, the amount of outstanding loans increased to Rs. 11.7 crores. Further, commercial papers of co-operative banks have been made eligible or rediscount at the Reserve Bank and the financing of the production and marketing activities of approved cottage and small-scale industries has been permitted.

Apart from the operations in the field of short and medium-term credit for agricultural purposes, the Reserve Bank undertook in 1948 to contribute up to 10 per cent. of the debentures floated by Land Mortgage Banks provided they were guaranteed by the Government in respect of principal and interest. Reserve Bank's contribution to such debentures was raised to 20 per cent. in 1950. Since 1953, the Reserve Bank of India, in consultation with the Government of India, has agreed upon a scheme of joint contribution to the debentures of Land Mortgage Banks up to 40 per cent. of the issue or the short-fall in public subscrip-

tion whichever was less, one half of the subscription being on behalf of the Government and the other half on account of the Reserve Bank. The Central Land Mortgage Banks using this facility have, however, to agree to dispense loans for productive purposes upto an amount not less than half of the joint subscription by the Government and the Reserve Bank within one year. The subscription to debentures of Land Mortgage Banks by the Reserve Bank during 1949-50 to 1959-60 amounted to a little less than 2 crores. Further, during 1958-59, 1959-60 and 1960-61 the Reserve Bank sanctioned credit limits amounting to Rs. 2.79, 2.45 and 2.74 crores to 12 state co-operative banks at 1½ per cent. below the Bank rate for financing the production and marketing activities of weavers' co-operative societies.

The Reserve Bank suggested ways and means of reorganizing the co-operative structure in various States and establishing apex banks in States where they did not exist, so that 6 new state co-operative Banks and 4 new Central Land Mortgage Banks were established.

Further, the Reserve Bank took the initiative in establishing a Co-operative Training College at Poona, where 40 senior officers are trained every six months, and 5 regional co-operative training institutes, where 240 intermediate personnel are trained every year.

Further, during 1958-59, 1959-60 and 1960-61 the Reserve Bank sanctioned credit limits amounting to Rs. 2.49 2.45 and 2.47 crores to 12 state co-operative banks at 1½ per cent below the Bank rate for financing the production and marketing activites of weavers' co-operative societies.

The further help of the Reserve Bank to the co-operative movement and agriculture, in pursuance of the recommendations of the Rural Credit Survey Committee, has been explained in section 16 of Chapter III.

The Bank has a special Agricultural Credit Department, the functions of which are—

(1) to maintain an expert staff to study all questions of agricultural credit and to be available for consultation by the Union and State governments, state co-operative banks and other banks ; and

(2) to co-ordinate the operations of the Bank in connection with agricultural credit and its relations with state co-operative banks, and any other banks or organizations engaged in the business of agricultural credit.

The Department is engaged in an intensive study of problems relating to rural finance, and the results of its investigations are being published in the form of bulletins from time to time, Further, its services are being utilized by State Governments and others for consultation and guidance regarding various problems of rural finance and schemes for the rehabilitation of the co-operative movement.

(g) *Important Departments of the Bank*—In addition to the Agricultural Credit Department, mentioned above, the Bank has the following important Departments :—(1) Department of Banking Operations, established in 1945. It deals with all problems relating to banks, such as fixing credit limits for the scheduled banks, carrying out on behalf of the Union Government inspections of banks applying for inclusion in the second schedule and of those which appear to be unsuitable for retention in the schedule or receiving fresh deposits, and inspection of banks under the Banking Companies Act, for a variety of purposes and on its own initiative, studying the returns submitted by banks, rendering advice on banking and financial matters to banks and Governments, banking legislation etc. (2) Department of Research and Statistics, established in 1945, under the general supervision of the Economic Adviser to the Bank. It has the following five Divisions :—(*i*) and (*ii*) The Divisions of Monetary Research and Banking Research prepare the Bank's various reports and are engaged in the study of problems relating to money, finance, the assets and liabilities of banks, the functioning of stock exchanges and the financial implications of development schemes and employment policy. (*iii*) The Division of Balance of Payments deals with problems of India's foreign trade and balance of foreign payments. (*iv*) The Division of Statistics compiles the Bank's monthly Statistical Summary and is engaged in the preparation of index numbers of wholesale prices, industrial security price, industrial production and profits of joint stock companies. (*v*) The Division of Rural Economics is studying problems relating to the stabilization of agricultural prices in India, rural insurance, income parity, the post-war plans of the States and agricultural co-operation in India. (3) Department of Banking Development established in 1950. It deals with all problems of development of banking and expansion of banking facilities in the country. (4) Department of Industrial Finance established in 1957. It deals

with all matters pertaining to industrial finance, including the affairs of the Refinance Corporation for Industry and State Financial Corporations.

(h) *The Reserve Bank and indigenous bankers.*—In May 1937 the Reserve Bank sent a circular letter to all scheduled banks and Shroff Associations stating that, under the prevailing conditions of great numbers of indigenous bankers and of highly personal and fluid character of their business, the Bank could deal with them only through some intermediate agency which would share with it the financial responsibility and undertake the necessary detailed examination and control, but that it was prepared to consider most carefully any practical scheme for organizing indigenous bankers to enable credit to be afforded to them direct. Such organizations must be self-contained legal entities with resources and deposits with the Reserve Bank at least equal to those stipulated for the scheduled banks, must maintain separate and properly audited accounts of their banking business, and must segregate their other businesses, which must be confined to *bona fide* trading, and must not be speculative. Pending the establishment of such organizations, the Bank suggested in the letter a provisional scheme by which the Bank would make advances against *bona fide* trade bills originating with a merchant or agriculturist, and endorsed by an indigenous banker and discounted with a scheduled bank, and against promissory notes originating with an indigenous banker with a possible second signature, and discounted by a scheduled bank. Scheduled banks would keep lists of indigenous bankers with whom they were prepared to do the above business, with a record showing the amount of the credit which could safely be given to them.

Shroffs' Associations and commercial organizations did not agree with these views of the Reserve Bank, which preferred indirect linking and suggested very onerous conditions for direct linking, on the ground that the views were contrary to the recommendations of the Central Banking Enquiry Committee, and made too much of the difficulties of direct linking. The Reserve Bank, therefore, announced in August 1937 another scheme for the direct linking of indigenous bankers with itself, in consonance with the recommendations of the Central Banking Committee, and stated that if it was approved by the indigenous bankers, the Bank would recommend legislation to

the Government of India for giving effect to it. Under it the indigenous bankers were to be registered in the books of the Reserve Bank and could open an account in any of the offices of the Bank, rediscount eligible paper with it, secure advances from it against Government securities, and obtain remittance facilities from it, in the same way as scheduled banks, if they satisfied the following conditions :—

(1) They must confine their business to banking proper as defined by the Indian Companies Act.

(2) They must file with the Reserve Bank the periodical statement prescribed for the scheduled banks, publish the returns prescribed for banking companies by the Companies Act, and be liable to the same penalties for non-compliance.

(3) They must have a minimum working capital of Rs. 2 lakhs, which must gradually be increased to Rs. 5 lakhs within a reasonable period.

(4) They must submit themselves, like the scheduled banks, to having their business regulated on banking lines, when necessary. But unlike the scheduled banks, they would be free from the obligation of keeping deposits with the Reserve Bank, unless any of their weekly statements showed that their time and demand liabilities exceeded five times the amount of their capital.

(5) They must furnish the names, and the extent of the interest, of their business partners, if any, and the names and interests of their co-sharers, if they belonged to a Hindu joint family. The partners and co-sharers must furnish statements undertaking their full share of the liabilities of the business.

The views expressed by different classes of indigenous bankers on the scheme showed that all of them disagreed with the Reserve Bank's suggestions regarding the taking of deposits and giving due publicity to accounts. Only some of them were agreeable to its conditions regarding the maintenance of accounts in an approved form. Although they generally agreed that speculative business should be ruled out, none of them was prepared to confine himself to banking business only. Hence they desired the Bank's scheme to be so modified as to be incompatible with its main proposals.

The Reserve Bank was therefore, compelled to communicate to the Government of India its inability to recommend legislation to amend the Reserve Bank Act for extending its provisions relating to scheduled banks to indigenous bankers. But, it stated in its

Statutory Report on Agricultural Credit referred to above that, if at any time in future the indigenous bankers were prepared to accept its scheme, or to suggest any practical alternative, it would be prepared to take the matter up with the Government of India with a view to legislation, and that in the meanwhile it was actively investigating the possibility of creating a bill market, in which bills were freely negotiated, by encouraging the formation of acceptance houses, or in other ways.

If such a market can be developed, it will be possible for the Reserve Bank to extend its open market operations to trade bills, as it has been doing to Government securities, and this will give first-class indigenous bankers the closer and ultimately the direct relationship that they wish, without compelling them to modify the essential character of their business, or to submit to unduly rigid restrictions. But we have considered in section 4 of the previous chapter the difficulties in the way of such a development, and the Reserve Bank itself appreciates them fully. The prospects of establishing a connection between the Bank and the indigenous bankers in this manner, therefore, are not at all bright. Hence, the feeling is growing among disinterested expert observers that the only solution of the problem lies in a compromise by which the Reserve Bank, realizing the impossibility of applying modern banking standards immediately to indigenous bankers, will temporarily relax the restrictions that it wishes to impose upon them, and the latter, realizing the necessity, in their own interests, of formalizing their methods of business on lines approximating to those of the joint-stock banks, will take steps to do so, so as to be ready to submit themselves gradually to more rigid restrictions of the Reserve Bank.

The Committee on Finance for the Private Sector recommended that the question of linking indigenous bankers direct with the Reserve Bank should be actively pursued by the Bank, but realized that owing to the reluctance of most of these bankers to segregate their non-banking business, it would take considerable time for the scheme to materilize. Meanwhile, it suggested that those shroffs who are doing their business by way of demand hundis should consider the possibility of introducing 90 days hundis where pacticable, introducing that to encourage the introduction of usance hundis, the Government of India should consider the question of reducing further the rates of stamp duty on such hundis and that the Reserve Bank should consider rediscounting of the

usance bills of indigenous bankers, such as the Shikarpuri shroffs, through scheduled banks. It further suggested that shroffs should maintain proper books of accounts, should establish an all-India association of their own and should be exempted from the purview of moneylending legislation.

As the indigenous bankers still cater to the requirement of the small-scale sector to an appreciable extent, the Reserve Bank has revived the proposal made by it in 1937 for a direct link and is considering certain avenues of affording facilities to them.

(i) *The Reserve Bank's direct dealing with the public.*—When in the opinion of the Central Board of the Bank, or of its Committee or Governor, if the Board delegates this power to it or him, it is expedient to regulate credit in the interests of Indian trade, industry and agriculture, the Bank is allowed by the Act to deal direct with individuals and firms by (i) purchasing, selling or discounting any of the bills or notes specified above under 'Discounts for scheduled banks', although they do not bear the signature of a scheduled bank or a state co-operative bank, or (ii) purchasing or selling sterling in amounts of not less than the equivalent of Rs. 1 lakh, or (iii) making loans or advances on the same conditions as those mentioned above for making them to scheduled banks. Thus, the normal relations of the Reserve Bank are with scheduled banks only, and it is not allowed to have direct dealings with commerce and the general public, as this will mean competition with the banks.

(j) *The Reserve Bank and Industrial Finance.*—In the field of industrial finance, the participation by the Reserve Bank has been gradually increasing. The Bank played an active part in the establishment of the Industrial Finance Corporation of India in 1948 and contributed to its share capital and bonds. Since 1952, the Corporation has been authorized by an amendment of the Industrial Finance Corporation Act to borrow funds from the Reserve Bank against specified types of securities. Moreover, the Reserve Bank has contributed Rs. 95 lakhs towards the share capital of the State Financial Corporations and has given them advice both on matters of policy and of personnel. It has also announced its decision to treat the shares and bonds of the Central and State Corporations as on a par with Government securities for the purpose of advances under Section 17(4) (a) of the Reserve Bank Act, as recommended by the Shroff Committee. Further, it is empowered to grant short-term financial accommodation to

the Corporations for the purpose of financing the production or marketing activities of approved cottage and small-scale industries. Finally, it took the initiative in forming the Re-finance Corporation for Industry (Private) Ltd., in 1957 and supplied a part of its capital. This is explained at the end of Section 9 Chapter IX.

(k) *The Bank and monetary reform.*—The Act has provided that when the Bank is of opinion that the international monetary position has become sufficiently clear and stable to make it possible to determine what will be suitable as a permanent basis for the Indian monetary system and to frame permanent measures for a monetary standard, it will report its views to the Government of India.

Except as otherwise provided above, the Bank is prevented by the Act from—

(1) engaging in trade, or otherwise having a direct interest in any commercial, industrial, or other undertaking, except such interest as it may acquire in the course of the satisfaction of its claims: provided that all such interests are disposed of as early as possible;

(2) purchasing its own shares, or the shares of any other bank or company, or granting loans upon the security of any such shares;

(3) advancing money on the mortgage of, or otherwise on the security of, immovable property, or becoming the owner of immovable property, except so far as is necessary for its own business premises and residences for its employees;

(4) making unsecured loans or advances;

(5) drawing or accepting bills payable otherwise than on demand; and

(6) allowing interest on deposits or current accounts.

(l) *Control of foreign exchange, gold and securities.*—Although the maintenance of the external value of a currency is achieved primarily by means of appropriate monetary and fiscal policies, in the abnormal conditions of the war and post-war years, most countries of the world, including India, have found it necessary to regulate the demand by the nationals for foreign exchange as well as the disposal by them of the foreign exchange earned. Such direct control is especially important for India for implementation of her Five Year Plans. The control is exercised by the Commerce and Industry Ministry of the Government of

India through import and export trade controls and by the Reserve Bank through exchange control. The control of all dealings in India in foreign exchange on account of the War was proscribed until February 1947 by the Defence of India Regulations, which were administered by the Reserve Bank on behalf of the Government of India. Since then the control is provided by the Foreign Exchange Regulation Act of 1947. The Bank has established an Exchange Control Department for this work. Exchange control has become necessary on account of the very heavy imports under the Five-Year Plan, in relation to the inadequate earnings of foreign exchange to pay for them. The aim of exchange control is to conserve foreign exchange resources by rationing them, so as to distribute them among competing import demands, in order to obtain maximum advantage to the nation, to prevent flight of capital and to make speculative or arbitrage operations in exchange impossible. To this end, all dealings of the public in foreign exchange are required to be transacted only through authorized dealers, which include the exchange banks and a few Indian banks.

Authorized dealers are permitted to cover spot and forward exchange transactions at market rates locally, in the London exchange market or with banks in the country of the currency concerned and these spot rates are allowed to fluctuate between the official buying and selling rates of the Bank of England. As India is a member of the sterling area, all excess foreign currencies acquired by authorized dealers are sold in the London market against sterling and the proceeds are repatriated to this country by the sale of sterling to the Bank.

The following payments are made to foreign countries.

Payment for imports.—Authorized dealers in foreign exchange are allowed to open letters of credit or make remittances in payment for imports into India provided the goods, are covered by a valid exchange control copy of an import licence or the goods are covered by an Open General Licence. Advance remittances are not usually permitted except in the case of import of capital goods requiring making of deposits with the overseas manufacturers.

Private remittances.—Nationals of sterling area countries other than India, who are temporarily resident, but not domiciled, in India, are permitted to remit in any currency of the sterling area up to a specified amount out of their current income to any sterling area country for maintenance of their families, payment

of insurance premia, etc. and authorized dealers may make such remittances without reference to the Reserve Bank. Foreign nationals temporarily resident in India are similarly granted reasonable remittance facilities for purposes; such as the support of their families.

Travelling expenses.—Reasonable exchange facilities are granted for business travel, education and medical treatment abroad according to the scales laid down for the purpose.

Other purposes.—Remittance of freight, profits, dividends and interest to beneficiary owners resident in any country outside India are allowed. All other types of remittances which are of a current nature are also allowed.

Capital remittances.—Sterling area nationals who are temporarily resident, but not domiciled, in India are permitted to repatriate their entire assets to any sterling area country at the time of retirement. Other foreign nationals who are resident, but not domiciled, in India are permitted to transfer at the time of retirement to their country of domicile all their current remittable assets.

Inward capital remittances.—Investment of foreign capital in India and its repatriation require the prior approval of the Bank. Repatriation facilities are freely granted to residents in the sterling area and Scandinavian countries. In the case of residents of other countries, repatriation facilities are granted only for investments after 1st January 1950 in projects approved by the Government of india.

Bulllion.—The import of gold and silver into India and the export of gold are prohibited except under a licence obtained from the Bank. The Bank does not at present issue any licences for the export of gold or import of bullion. The export of silver is subject to licence by the Export Trade Control authorities.

The control of foreign exchange also covers the earnings of foreign currencies from exports of goods from this country to other countries. The export of goods to foreign countries is permitted, provided the exporter makes a declaration on a prescribed form to the Collector of Customs that the foreign exchange representing the full value of the goods has been or would be disposed of in a manner and within the period specified by the Reserve Bank. The control on exports is designed to ensure that foreign exchange proceeds of exports are remitted to India and not retained abroad and that exports are financed in certain specified ways so that export receipts of the country are at the maximum. The banks and shippers are

required to complete statements setting out therein the value of shipments and the method of finance. The Customs do not permit shipments to specified countries without production of a shipment form which, on receipt, is forwarded to the Bank. The other copies of the shipment form are delivered by the shippers to their bankers at the time of negotiation of their bills covering the export. These are also submitted to the Reserve Bank which checks up the forms with the originals received and thus ensures that all shipments are accounted for.

The export of securities is prohibited except under a licence from the Bank, and persons wishing to send securities abroad for transfer, sale, etc., are required to apply to the Bank for a licence through an authorized dealer in foreign exchange. The transfer of rupee securities or the creation or transfer of an interest in a rupee security to or in favour of persons resident outside India is prohibited except with the general or special permission of the Bank.

6. *Effectiveness of the performance of the Reserve Bank functions: Central Banking Control.*—The Reserve Bank is performing most of the functions considered above satisfactorily, but it is doubtful whether it can perform a few of them in the same manner, under the prevailing conditions. Thus, the monopoly of note issue is meant to give it complete control over the amount of cash and therefore credit in the country, as notes form the most important part of the purchasing power of the country, current deposits come next, and rupees the last.[1] But the Bank finds it difficult to obtain the complete control for the following reasons :—

(1) Its present reserve is so regulated as to secure a certain volume of gold or sterling securities. Only a small quantity of rupees is kept in the reserve for meeting the demand of the public for small change. The reserve is thus held primarily for meeting the external liabilities of the country.

(2) The scheduled banks keep with themselves a substantial reserve in the form of notes, in addition to the 5 and 2 per cent. of the demand and time liabilities that they are obliged to keep with the Reserve Bank. They can use these notes for supporting inflation for some time without approaching the Reserve Bank.

[1] See Muranjan, op. cit., p. 252.

(3) The Reserve Bank has to face the obstacles of absence of an organized money market ready to respond speedily and wisely to the central banking policies of the Bank, the vast areas over which monetary influences generated in a few financial centres have to spread, and the existence of a number of non-scheduled banks, possessing nearly one sixth of the total banking offices in India and yet outside the sphere of the influence of the Bank.

In spite of the above difficulties, there is no doubt that the Reserve Bank has been able to exercise considerable influence over the money market. This is seen from the facts that it has removed the seasonal stringency from the money market and maintained a uniform bank rate for several years. This has produced a healthy influence upon the other rates in the market. Not only have they come down absolutely, but also the divergences between them have been reduced. Moreover, a considerable improvement is noticeable in the organic contact and inter-relationship between the different money markets in India, expecially Bombay and Calcutta. There is no longer any great disparity between the Bombay and Calcutta bazaar rates. Another indication of the influence of the Reserve Bank is the stimulus that it has given to the development of sound banking practices and standards. This, in turn, is bound to increase its control over the market.

Before the Second World War, the open market operations of the Reserve Bank in the form of purchase or sale of securities were on a very moderate scale and their chief purpose was either the maintenance of the market prices of Government securities or preparation of the market for the floatation of a new loan. They were also resorted to, sometimes, for relieving seasonal stringency. After the War, the Reserve Bank has resorted to them on a substantial scale for maintaining security prices in the market, relieving the heavy pressure on banks for seasonal funds and stabilizing the banking and financial structure generally, thereby producing a steadying influence on the money market and the banking system. Further, the Reserve Bank has also attempted occasionally to guide the choice of the market. Thus, if it desired the market to absorb a particular kind of security, it has endeavoured to induce institutional investors, such as the larger banks and insurance companies, to take up securities held by it, offering some profit on such transactions

as an inducement and undertaking to keep prices and returns steady.[1]

Furthermore, the Reserve Bank has induced and helped commercial banks to secure a more balanced distribution of the maturities of their security holdings. In 1948, it issued circulars to them pointing out that they were showing too marked a preference for long-dated securities and suggesting that they should build up a stronger second line of defence in the form of holdings of short-term securities and that they should reduce their holdings of long-term securities gradually so as not to disturb the Government securities market and to be able to support the Government securities market, if necessary. As a result of these circulars, banks brought about a progressive improvement in the maturities of their holdings of Government securities.[2] At the same time, the Reserve Bank has attempted to keep the market in long-term securities healthy, by giving its support in the form of buying the securities, when necessary.

The open market operations of the Reserve Bank have been carried out mostly in Bombay and Calcutta and to a small extent in Madras. The scale of operations has been larger in Bombay than in Calcutta.

The bill market scheme, which was initiated by the Reserve Bank in 1952 and which has developed appreciably since then, has also helped the Reserve Bank to obtain some control over the money market, by relieving seasonal stringency. This scheme has been explained in section 2 of the preceding chapter.

The unique position of the State Bank, mentioned in section 4 of the tenth chapter, as a buffer between the Reserve Bank and the money market and as the sharer of the control and guidance of the money market with it, fortunately does not constitute a threat to its proper and efficient functioning for two reasons. Firstly, the relations between the two have been quite harmonious; and secondly, it is appreciated that while, in a difficult period, the Reserve Bank will provide the emergency currency and credit, the State Bank, in the near future at least, will distribute them among the other banks, as a wholesaler, and the latter will retail them to the public. Although the scheduled banks can borrow direct from the Reserve

[1] See *Banking in the British Commonwealth*, edited by Sayers, p. 240.

[2] See Report of the Reserve Bank on the Trend and Progress of Banking in India in 1949, p. 222.

Bank, they may prefer doing so from the State Bank for two reasons. Firstly, they have had a long connection with the State Bank; and secondly, while the conditions for borrowing from the Reserve Bank are narrow and strict, the State Bank is tied down much less by law and can grant credit more liberally, when it is satisfied about the position of the borrowing banks.[1] Hence, the narrow definition of paper eligible for rediscount by the Reserve Bank need not cause much hardship to scheduled banks or impair the influence of the Reserve Bank on the market.

As speculative holding of some agricultural commodities, financed by bank credit, was tending to aggravate inflationary pressures in 1957 and as it was thought necessary to stem them, the Reserve Bank brought into play some credit controls. A general restriction on the quantity of credit was sought to be operated through raising the cost of borrowing by banks from the Reserve Bank. The effective rate of borrowing under the Bill Market Scheme was raised to 4% by increasing the stamp duty on usance bills. At the same time the Bank raised its lending rate against Government securities to 4% by raising the bank rate to that level. A little later, the Governor of the Reserve Bank advised scheduled banks by means of a circular letter, to bring about a reduction in the total of bank credit during the ensuing slack season and indicated to them that the Reserve Bank's lending policy under the Bill Market Scheme would be one of general restraint and greater selectivity than previously.

To check the rising trend of the price level in the country in recent years, resulting from the expansion of currency for financing the Second and Third Five Year Plans, the Reserve Bank has been exercising general as well as selective controls on the expansion of the grant of credit by the banks, with a view to checking the grant of credit for speculative activities and hoarding of stocks, without checking the grant of more credit required for the genuine productive activities in the country.

The general credit control by the Reserve Bank has taken the form of raising the rate of interest charged by it for lending against usance bills and against Government and other approved securities from 3½ to 4 per cent. and of directing the banks to pursue a cautious lending policy, to refrain from excessive lending against commodities and from assisting speculative hoarding of stocks,

1 See Ghose, *A Study of the Indian Money Market*, p. 177.

and to reduce their total advances to a certain lower level during each slack season.

Another measure devised by the Reserve Bank for exercising general credit control was the imposition of additional but variable reserve ratios. In March 1960 it directed all scheduled banks to keep with it (Reserve Bank) 25 per cent. of the addition to their liabilities after 11th March 1960, over and above the statutory reserve of 5 and 2 per cent. of their demand and time liabilities, which they had always to keep with it. In May 1960, the amount which the scheduled banks had to keep with the Reserve Bank was increased from 25 to 50 per cent. of their additional liabilities. The Reserve Bank paid them interest on the additional deposits at ½ per cent. more than the interest paid by them on their deposits. The additional reserve requirement was revoked partially in November 1960 and completely in January 1961.

The above measure failed to make significant impact on the level of bank credit, because banks had easy access to borrowing from the Reserve Bank at a comparatively low cost. To raise the cost of such borrowing, in October 1960, the Reserve Bank introduced a system of slabs of interest rates under which the borrowings of scheduled banks from the Reserve Bank were regulated by means of a three-tier structure of rates related to the extent of their borrowing. Accordingly, each scheduled bank was assigned for purposes of its borrowing from the Reserve Bank at the Bank rate, viz. 4 per cent, a quota for each quarter, equal to half of the average amount of statutory reserve which it was required to keep with the Reserve Bank during the previous quarter. Any borrowing over this level upto 200 per cent. of the quota was charged interest at 5 per cent; and all borrowing in excess of 200 per cent. of the quota was charged interest at 6 per cent.

At the peak of the busy season at the end of March 1961, the borrowings of banks from the Reserve Bank rose to Rs. 94.5 crores. Two-thirds of this amount was borrowed at 6 per cent; one-sixth at 5 per cent. and the balance of one-sixth at the bank rate, namely 4 per cent. As a result of these penal rates, banks reduced their borrowings from the Reserve Bank by as much as Rs. 93 crores during the next five months, Rs. 56 crores being repaid in April alone.

In July 1962, the Reserve Bank tightened up the above system by changing it from three-tier to four-tier. The quota was reduced

from half to quarter of the statutory reserve, borrowing upto this quota was charged interest at 4 per cent. borrowing over this level upto 200 per cent. of the quota was charged interest at 5 per cent. borrowing in excess of 200 per cent and upto 400 per cent. of the quota was charged interest at 6 per cent. and all further borrowing had to pay interest at 6½ per cent.

In November 1962, on account of the situation created by the Chinese aggression on the northern border of India, the Reserve Bank tightened the system further by laying down that it would lend to banks as follows :—

(i) an amount equivalent to 25 per cent. of a bank's statutory reserve kept with it (Reserve Bank) at 4 per cent. (bank rate); (ii) an additional equivalent amount at 5 per cent.; and (iii) an additional 50 per cent. of the statutory reserve at 6 per cent. The Reserve Bank announced that it would not normally lend beyond the limit of 100 per cent. of a bank's statutory reserve and that if a bank were to find itself in a special situation requiring further loans beyond the ceiling mentioned above, the Reserve Bank would consider the grant of further loans only after making detailed assessment of the bank's overall position and of its real need for additional accommodation.

A fourth measure of general credit control was the imposition by the Reserve Bank in March 1960 of ceiling on clean (i.e. unsecured) advances made by scheduled banks, so that the ratio of clean advances to total advances in any month was not to exceed the corresponding ratio in 1959. A fifth measure adopted in October 1960 was the directive of the Reserve Bank to all scheduled banks to adhere to a minimum lending rate of 5 per cent. on all advances except those to other banks and bank employees, and to raise their average lending rate at least by ½ per cent.

The Reserve Bank has imposed its selective credit controls in a flexible manner, tightening, relaxing, removing and re-imposing them according to changes in the price situation. In May 1956, the Reserve Bank directed all scheduled banks not to increase any credit limits in respect of advances against the security of paddy and rice or sanction any fresh credit limit in excess of Rs. 50,000 in respect of such advances, to increase the existing margin in respect of the limits and advances by an amount not less than 10 per cent of the value of these commodities and to reduce their aggregate advances against these commodities to a

level not exceeding 25 per cent. above that prevailing at the corresponding time in the previous year. In September 1956 the Bank issued similar directives in respect of other foodgrains and cotton textile goods. The Reserve Bank tightened, relaxed, withdrew or reimposed these directives from time to time according to the changing needs of the price situation in the country. It also did the same in respect of oilseeds, sugar, jute and jute textile goods. In March 1960, it directed all scheduled banks to impose a minimum margin of 50 per cent. in respect of their advances against ordinary shares above an amount of Rs. 5000 and to refrain from direct financing of badla transactions through purchase of shares in their name for the current settlement and sale for the next settlement.

7. *Statement of Affairs of the Reserve Bank.*—The functions of the Reserve Bank mentioned above are brought out by the following statement of affairs of the Bank for the week ended 31st August 1962.

Issue Department

	Crores of Rs.		Crres of Rs.
Liabilities :		*Assets :*	
Notes held in the Banking Department ..	42.15	A. Gold coin and bullion—	
Notes in circulation	2011.38	(*a*) Held in India	117.76
		(*b*) Held outside India	..
		Foreign securities	88.34
		Total of A..	206.10
		B. Rupee coin	124.43
		Govt. of India Rupee securities	1723.00
		Internal bills of exchange and other commercial paper ..	
Total..	2053.53	Total..	2053.53

Banking Department

Liabilities	Crores of Rs.
Capital paid-up ..	5.00
Reserve Fund	80.00[1]
National Agricultural Credit (Long Term Operations) Fund ..	61.00
National Agricultural Credit (Stabilization) Fund ..	7.00
Deposits—	
(a) Government—	
Central Government ..	92.12
(*ii*) State Governments	34.85
(*b*) Banks ..	81.13
(*c*) Others ..	164.19
Bills Payable ..	29.87
Other Liabilities ..	22.13
	577.29

Assets	Crores of Rs.
Notes ..	42.15
Ruepe and small coin ..	0.05
National Agricultural Credit (Long Term Operations) Fund—	
(*a*) Loans and advances to—	
(*i*) State Governments ..	24.03
(*ii*) State Co-operative Banks ..	11.96
(*b*) Investment in Central Land Mortgage Debentures ..	2.85
Bills purchased and discounted	
(*a*) Internal ..	..
(*b*) External ..	..
(*c*) Government Treasury Bills ..	73.74
Balances held abroad ..	5.76
Loans and Advances to Governments ..	2.24
Loans and Advances to—	
(*i*) Scheduled Banks ..	15.93
(*ii*) State Co-operative Banks ..	127.01
(*iii*) Others ..	1.17
Investments ..	236.32
Other Assets ..	34.08
	577.29

The following was a consolidted statement of the affairs of the Scheduled Banks, which were members of the Reserve Bank, for the week ended 24th August 1962 :—

	Crores of Rs.
1. Demand liabilities—	
(*a*) Demand deposits—	
(*i*) From banks	48.39
(*ii*) From others	798.01
(*b*) Borrowings from banks	19.51
(*c*) Others	54.81
2. Time liabilities—	
(*a*) Time deposits—	
(*i*) From banks	24.70
(*ii*) From others	1,256.14
(*b*) Borrowings from banks	18.47
(*c*) Others	12.23
3. Aggregate deposits (1)(*a*)(*ii*) *plus* (2)(*a*)(*ii*)	2,054.15

1 Rs. 75 crores out of the Reserve Fund of Rs. 80 crores represent the major portion of the profit, on the revaluation of the Bank's gold stocks in terms of the Reserve Bank Amendment Act, 1956. (See the last section of this chapter.)

4. Borrowings from Reserve Bank	
(a) Against usance bills and/or promissory notes	..
(b) Others	.73
5. Borrowings from State Bank and/or a notified Bank	17.76
6. Cash	52.21
7. Balances with Reserve Bank	98.78
8. Cash and balances with the Reserve Bank	150.00
9. 8 as per cent. of 3	7.35
10. Balance with other banks in current account	20.24
11. Money at call and short notice	49.61
12. Investments in Government securities	680.84
13. 12 as per cent. of 3	33.14
14. Advances—	
(a) Loans cash credits and overdrafts	1,195.10
(b) Due from banks	7.18
15. Inland bills purchased and discounted	130.47
16. Foreign bills purchased and discounted	48.66
17. Total Bank Credit (14(a)+15+16)	1,374.23
18. 17 as per cent. of 3	66.90

8. *Agreement of the Reserve Bank with the Imperial Bank.*—The Reserve Bank entered into an agreement with the Imperial Bank of India, which was approved of by the Governor-General in Council, and ran for 15 years. It has continued thereafter and can be terminated after 5 years' notice on either side. The agreement is conditional on the maintenance of a sound financial position by the Imperial Bank, which is now the State Bank of India. If in the opinion of the Central Board of the Reserve Bank, the State Bank has failed to do this or to fulfil the conditions of the agreement, it will make a recommendation to the Government of India, which may issue instructions to the State Bank with reference to the agreement or to any matter involving the security of Government money or the assets of the Issue Department of the Reserve Bank in the custody of the State Bank and, if it disregards the instructions, may terminate the agreement.

Under this agreement, the State Bank is the sole agent of the Reserve Bank at all places in India where, at the commencement of the Reserve Bank Act, there was a branch of the Imperial Bank and no branch of the Reserve Bank. In consideration of the performance by the Imperial Bank, on behalf of the Reserve Bank of the functions which the former had been performing on behalf of the Governor-General in Council at these places, the Reserve Bank had to pay it a commission on the total of the receipts and disbursements dealt with annually by it on account of Go-

vernment at the rate of 1/16 per cent. for the first Rs. 250 crores and 1/32 per cent. for the remainder during the first 10 years. These rates had to be revised afterwards for every 5 years after examining the cost to the Imperial Bank and its successor the State Bank of performing these functions. Accordingly, the revised rates for the quinquennium 1st April 1955 to 31st March 1960 were Re. 0.06 for every 100 rupees on the first Rs. 600 crores, Re. 0.04 for every 100 rupees on the next Rs. 600 crores, Re. 0.02 for every 100 rupees on the next Rs. 1200 crores and Re. 0.01 for every 100 rupees on the remainder of the total of receipts and disbursements dealt with annually on account of Government by all branches of the State (Imperial) Bank on behalf of the Reserve Bank of India.

Further, subject to the condition that the Imperial Bank kept open branches not less in number than those existing at the time of the commencement of the Reserve Bank Act, the Reserve Bank paid the Imperial Bank Rs. 9, 6 and 4 lakhs per annum during the first, second and third period of 5 years each respectively of the agreement. The Imperial Bank could not, without the approval of the Reserve Bank, open any branch in substitution of a branch existing at the time at which the agreement came into force, and the Reserve Bank was free to open its own offices at any places, notwithstanding the fact that the Imperial Bank had up to then acted as its agent at those places. The State Bank's position is the same.

A fresh agreement between the Reserve Bank and the State Bank for the performance of agency functions was concluded on 16th March 1960. It has been modelled on the lines of the previous agreement. Moreover, the State Bank, with the approval of the Reserve Bank, entered into similar agency agreements, with each of its eight subsidiary banks. Under the agreements, which came into force on 1st October 1960, the branches of the subsidiary banks conduct Government business at centres, where there are treasuries and sub-treasuries, in the areas of their operations and provide exchange and remittance facilities to the public on behalf of the Reserve Bank and as agents of the State Bank. Currency chests are being gradually established at the branches of these banks to enable them to perform the agency functions. The remuneration paid by the State Bank to the subsidiary banks, at rates fixed under the agreements, are reimbursed to it by the Reserve Bank.

9. *Dividends and reserve fund of the Reserve Bank.*—As regards the payment of dividends to the shareholders of the Reserve Bank and the share of Government in the Bank's profit, the Act of 1934 provided that after payment out of the net annual profits of a cumulative dividend on the share capital at such a rate not exceeding 5 per cent. as the Governor-General in Council might fix at the time of the issue of the shares, a portion of the surplus would be allocated to the payment of an additional dividend according to the scale laid down in a separate schedule and the balance of the surplus would be paid to the Governor-General in Council: provided that, so long as the reserve fund was less than the share capital, not less than Rs. 50 lakhs of the surplus, or the whole of the surplus, if less than that amount, was allocated to the reserve fund. The rate of dividend fixed by the Governor-General in Council at the time of the issue of the shares was $3\frac{1}{2}$ per cent. For the year 1939, the net profits of the Bank amounted to Rs. $22\frac{1}{2}$ lakhs, out of which Rs. $17\frac{1}{2}$ lakhs were distributed as dividend at $3\frac{1}{2}$ per cent. and the rest was paid to the Government of India, as the Bank's reserve fund was already as large as its share capital, *viz.* 5 crores. As a result of war finance, the profits of the Bank jumped up to Rs. 2.79, 3.42, 7.70, 10.27, 14.89 and 13.63 crores for the years ended on 30th June 1941, 1942, 1943, 1944, 1945 and 1946 respectively. An ordinance was passed in June 1943 raising the dividend rate temporarily to 4 per cent. This increased the total amount to be distributed in dividends to Rs. 20 lakhs. The rest of the huge profits were paid to the Government of India. The profits have gone on increasing and since the nationalization of the Bank, they have been paid entirely to Government. For the year ended on 30th June 1962 the Bank thus paid Rs. 43.5 crores to Government.

The Bank has to announce to the public from time to time the minimum rate at which it is prepared to buy or rediscount bills of exchange or other commercial paper eligible for purchase under the Act. It has also to submit weekly and annual accounts of the Issue and Banking Departments to the Government of India which causes them to be published in the Government Gazette.

10. *Policy of the Reserve Bank.*—The establishment of the Reserve Bank was not cordially welcomed by a few of the other banks, which regarded it as an engrafted and extraneous body. Its privileges as the fiscal agent of Government, its free funds

provided by Government and other banks, its monopoly of note issue and its potential competitive power produced in them a feeling of doubt against it, This might have delayed that co-ordination and co-operation between the component parts of the money market in India, to secure which the Reserve Bank of India had been established.

It was essential, therefore, that the Reserve Bank should endeavour to secure the confidence and willing help of the other banks, so that when it had to exercise control to the temporary disadvantage of any section of the money market, in the interests of the money market and the banking system as a whole, the control might be accepted without opposition and ill-will by all the banks and bankers. If its policy were to be directed on the right lines, it would not have been long before it was universally regarded as a natural and healthy development which had evolved from, and for the benefit of, the banking system of India as a whole.

Some authorities, therefore, suggested that the power given by the Reserve Bank Act to the Bank to accept deposits without interest from the members of the public should be withdrawn, and that, as the Act empowered the Bank to have dealings with them, *i.e.* open market operations, to some extent, the Act should clearly lay down that the Bank should have such dealings, only when they were absolutely necessary to make its credit or exchange policy effective, and that it must liquidate them as early as possible.[1] It should also endeavour to secure the goodwill of the public by making its management free even from a suspicion of being influenced by interests other than those calculated to promote the economic welfare of India. It is generally admitted that during the twenty-five years of its existence the Reserve Bank has, on the whole, pursued right policies and has secured the confidence of other banks, the public and the Government.

The creation and working of the Reserve Bank, as explained before, have synchronized with continued low interest rates. The bank rate, which had remained at 7 per cent. for the greater part of 1931, fell to 3½ per cent. when the Bank was established. The Bank reduced it to 3 per cent. at the end of 1935, and it remained at this level until November 1951, when it was raised to 3½. It was raised again to 4 per cent. in May 1957 and

[1] See Bhatter and Nemenyi, *The Reserve Bank of India and its Functions*, pp. 65-6 and 73.

to $4\frac{1}{2}$ per cent. in January 1963. Had not the Bank existed, the revival of economic activity from 1937 would have re-established the former heavy seasonal fluctuations in the rates. The difference between the maximum and minimum values of notes held by the Bank in its Banking Department in any year, indicates the seasonal pressure for funds which it has borne without changing its rate. The average of the seasonal differences in the cash held by the Imperial Bank during 1921-9 was Rs. 12 crores only, but during this period there were heavy seasonal fluctuations in the rates. The much larger variations in the value of notes held by the Reserve Bank in its Banking Department during the later years, although they were years of lower prices and reduced economic activity, while the cash balances held by the Imperial Bank were much higher than before, show that the former seasonal fluctuations in rates would have re-asserted themselves, if the Reserve Bank had not existed.[1] Thus, the Reserve Bank has been instrumental in removing the seasonal fluctuations in the rates, and India has benefited from this policy of the Bank in a greater measure after the War.

Adverse criticism of the Bank's policy was made during a local banking crisis in South India in the middle of 1938, which resulted from the failure of the Travancore National and Quilon Bank, and which unfortunately marred the steady development of the scheduled banks, maintained from the establishment of the Reserve Bank. This failure created nervousness among depositors in South India regarding other banks in this area, and there was a run on some of these banks, but the other areas remained unaffected. The Reserve Bank met the crisis by sanctioning larger credit limits more than once to banks in South India. Consequently, the acute phase of the crisis disappeared in a short time. A feeling of nervousness, however, continued in South India until the end of 1938. The criticism came from the South Indian Chamber of Commerce and the scheduled banks of that area. They complained of failure of expected help from the Reserve Bank, which insisted on an examination of the affairs of the Travancore National and Quilon Bank, before giving any help to it. But, it was contended that news of this examination was bound to leak out and to precipitate the very crisis which it was the object of the help to avoid. The proper time for the Reserve Bank to make sure that the general

[1] See Muranjan, op. cit., p. 285.

condition of the Travancore National and Quilon Bank was not unsound was, not when the latter was struggling to escape suspension, but during the previous three years when it was a scheduled bank. Only two years previously, the Reserve Bank had aided it substantially to enable it to carry out its amalgamation, and could not have done so without previous investigation. As Dr. Muranjan has pointed out, there was much substance in this criticism.[1]

The crisis revealed the necessity of the scheduled banks maintaining a closer touch with the Reserve Bank so as to give it a clearer idea of their position and working, and to enable it to give credit to deserving banks without delay. On behalf of the Reserve Bank, it was stated that the essential preliminary to any active help to a bank in difficulty must be that the Reserve Bank must feel certain that the bank seeking assistance was sound and, therefore, deserving of such assistance. Until then the only knowledge which the Reserve Bank had about the affairs of the scheduled banks was supplied by their published balance-sheet and the weekly statements of time and demand liabilities. This information was insufficient to enable the Bank to form a correct opinion about the true financial position of a scheduled bank. Moreover, the Reserve Bank could give valuable financial help to a bank in difficulty by rediscounting its bills. But to be able to give this aid the Bank must have adequate information about the standing of the parties whose names appeared on the bills. The Bank, therefore, should have periodically from scheduled banks up-to-date lists of such parties with information about their loan operations and standing. Hence, after the crisis was over, the Reserve Bank issued two circular letters to all scheduled banks explaining the nature of its relations with them, laying down a policy for their guidance for obtaining advances and discounts from it, and asking for more detailed voluntary information regarding their bills, advances and investments.

In 1938 the Indian Companies Act was amended so as to make non-scheduled banks submit their returns to the Registrars of Joint-stock Companies in triplicate, and under the instructions of the Government of India, the Registrars send a copy of these returns to the Reserve Bank. At the end of 1938 the Reserve Bank sent a circular letter to all non-scheduled banks having a

[1] See Muranjan, op. cit. p. 286.

capital of Rs. ½ lakh or over enquiring whether they would supply the Reserve Bank with regular information regarding their operations, so that it might help them with advice and guidance, when necessary.

It received a good response from many of them, and the contacts thus established undoubtedly helped the development of a sound banking system in India.

The passing of the Banking Companies Act in 1949 and several subsequent amendments to it have given the Reserve Bank wide powers of compelling banks to submit to it numerous periodical returns giving full information regarding different aspects of their functioning, of inspecting banks from time to time and of issuing directives to them regulating their working. The Reserve Bank has made large and wise use of these powers. The banks, on the whole, have co-operated well with the Reserve Bank, in the use of the powers by the latter. Hence, for the last ten years or so, the Reserve Bank has possessed good information regarding the position and working of banks and has been in a position to help readily those banks, which may get into difficulties. Actually, it has given quick help to those banks, which have had to meet runs upon them, provided that their financial condition was not too weak and also helped banks to meet minor crises which have taken place in some parts of the country. It has also used its powers to bring about liquidation or compulsory amalgamation with strong banks, of those banks whose financial condition had become too weak. Thus, the Reserve Bank has become a true friend, guide and controller of all the banks in the country.

The working of the Reserve Bank during the last 25 years shows that it has inaugurated a new era of financial stability, banking reform and development of the money market. It has been very successful in floating loans for the Union and State Governments at very low rates, in the sale of Treasury Bills and in making remittances abroad on behalf of the Government of India. It has given valuable advice to Government on various financial and banking problems. It has provided cheap inland remittance facilities, helped to lower money rates and encouraged the extension of banking facilities in India. It is true that it has not yet succeeded in fulfilling two expectations, *viz.* development of a regular bill market in India and linking the indigenous bankers to itself, but this failure has been due to the difficulties considered above. It cannot be blamed also for the infla-

tion of paper currency that has taken place in India as a result of the War finance, and financing of National Plans of development, because all Central Banks have to be the instrument of their respective Governments in these matters. It has tried to check the evil effects of inflation by sending circulars to banks, from time to time, advising and directing them to restrict their advances to genuine trade requirements and not to grant any accommodation for speculative purposes. The future of banking in India will depend greatly upon the building up of healthy traditions and conventions by the Reserve Bank, and the work done by it in this direction so far has been on the whole quite satisfactory.

11. *The Reserve Bank of India (Amendment) Acts*, 1956, 1957 *and* 1960.—The Act of 1956 contains the following main provisions :—

(1) Of the total amount of the assets kept in the Issue Department of the Reserve Bank of India as the reserve against the note issue, the amount of gold coin or gold bullion and the amount of foreign securities shall not at any time be less than 115 crores of rupees and 400 crores of rupees respectively in value. The Reserve Bank, however, may, with the previous sanction of the Union Government, for periods, not exceeding six months in the first instance, which may, with the like sanction, be extended from time to time by periods not exceeding three months at a time, hold as assets foreign securities of an amount not less than 300 crores of rupees in value.

(2) The value of gold held in the reserve shall be written up from Re. 1 for 8.47512 grains to Re. 1 for 2.88 grains.

(3) The Reserve Bank may, by notification in the *Gazette of India*, increase the average daily balance which scheduled banks have to keep with it from 5 per cent. up to 20 per cent. of their demand liabilities and from 2 per cent. up to 8 per cent. of their time liabilities. The Reserve Bank, however, may pay to the scheduled banks interest at such rate as may be determined by the Bank from time to time on the excess amount of balance which the scheduled banks are asked to maintain with it by the above notification.

The reason for including the first provision in the Act is that the previous provisions in the Reserve Bank of India Act in regard to reserve requirements placed a serious limitation on the ability of the Reserve Bank to bring about the expansion of currency needed to meet the requirements of the Second Five-Year Plan.

The process of planned economic development necessarily implies a certain amount of credit creation and a consequent increase in the note issue.

No comment is needed on the provision for writing up the value of gold, as the new rate has been agreed to by the International Monetary Fund.

The reason for the inclusion of the third provision is that deficit financing in the Second Five-Year Plan may result in a large addition to bank reserves with consequent increase in the capacity of banks to create credit. In order to control such creation of credit by banks, it is said to be necessary to grant additional powers to the Reserve Bank to regulate credit expansion and to check the development of inflationary trends. But, under Section 21 of the Banking Companies Act, the Reserve Bank has already ample authority to control advances by banks, so as to curb their inflationary credit. A change in the reserve requirement of banks is, therefore, not necessary for the above purpose, at least at this stage.

The Act of 1947 provides that the aggregate value of the gold coin, gold bullion and foreign securities held as assets by the Reserve Bank and the aggregate value of the gold coin and gold bullion so held shall not at any time be less than 200 crores of rupees and 115 crores of rupees respectively.

The Act of 1960 empowers the Reserve Bank (1) to act as agent of the Central Government for guaranteeing loans given by banks or other financial institutions to small-scale industrial concerns approved by the Central Government and (2) to give medium-term loans to the State Financial Corporations and other financial institutions approved by the Central Government, upto 60 per cent. of their paid-up capital.

12. *Collection and furnishing of credit information.*—A clause in the Reserve Bank of India (Amendment) Act 1962 has empowered the Reserve Bank to collect in such manner as it may think fit credit information from banking companies and, subject to certain restrictions, to furnish it to any banking company. The Reserve Bank is empowered to direct any banking company to submit this information to it, notwithstanding any other legal or contractual obligation on it not to do so. Whenever a banking company needs this information in connection with a financial arrangement entered into or proposed to be entered into by it with a customer,

it can obtain the information by applying to the Reserve Bank. Credit information has been defined as any information relating to the amounts and the nature of loans, advances and other credit facilities granted by a banking company to a borrower, the nature of the security taken by it from him and the guarantee furnished by it to any customer.

The Credit Information Bureau, which the Reserve Bank will set up under the above powers, will function as a clearing house of information relating to loans, advances and guarantees given by more than one bank to the same borrower. For some time, the Reserve Bank proposes to collect the information in respect of each borrower, who has obtained unsecured credit limit of Rs. 1 lakh and above or secured credit limit of Rs. 5 lakhs and above. The Reserve Bank will pool this information in respect of each borrower and supply it to a bank, which may apply for it in respect of particular borrowers. At present, a bank has no means of knowing the credit limits which its borrowers have obtained from other banks, except the information that may be voluntarily disclosed to it by its borrowers. Later, the Reserve Bank may collect the information in respect of smaller borrowers. In supplying the information to a bank, the Reserve Bank is debarred by the Act from giving the names of the banks which have submitted it to the Reserve Bank. Moreover, the Act lays down that the information must be kept confidential and can be used only for the purpose for which it is collected and supplied, namely enabling the banks to prevent overtrading on the part of their customers, by ensuring that the overall credit limits granted to the customers by more than one bank, are not excessive.

The above Bureau cannot supply any information to banks regarding the creditworthiness, general financial reputation and the market standing of their customers. Individual banks collect this information themselves for their own use. They are, however, generally reluctant to make the information available to other banks, partly because the latter are their competitors and partly because they are afraid of the legal consequences that may follow from any part of the information being regarded later as defamatory by a law court. There is, therefore, need for the establishment of a private commercial agency for the collection of such information, under the combined auspices of the Indian Banks' Association, the Exchange Banks' Associations, and the State Bank of India, like Seyd's in England and Dun and Bradstreet's

in the U.S.A., in addition to the Bureau which is being set up by the Reserve Bank. Banks will have to purchase information regarding their customers from the agency, which will need legal protection for its functioning.

CHAPTER XIII

REGULATION OF BANKING

1. *Inadequacy of the Indian Companies Act,* 1913.—Until the beginning of 1937 joint-stocks in India were registered under the Indian Companies Act of 1913, and were governed by its general regulations, with the exception that in a few matters the Act made a distinction between banks and other companies and contained a few special regulations applicable to banks only.

The general opinion in India was that this Act had provided very inadequately for the regulation of banking, and had left many banking institutions altogether free from regulation. In all countries, banking business is regarded as semi-public in character, as banks serve as the repositories of the savings of the people and influence their economic life deeply and, therefore, special banking legislation is regarded as essential for protecting the depositors on whose confidence the whole banking system vitally depends, and for promoting the growth of the banking system on sound lines.[1] Such legislation has been enacted in most Western countries. It is true that in England there is no special banking legislation apart from the Companies Act, but its object is served by the tradition, convention and case law that have been developed in the course of centuries.

2. *Need of a special Bank Act.*—It is true that no banking regulation, however elaborate, can prevent unsound management, losses and failures; that banks and bankers cannot be made by mere Acts of the Legislature; that elaborate restrictions and regulations may do more harm than good, by hampering the activities of banks and the sense of responsibility of their managers and directors; and that many banking matters are best left to the discretion and the sense of responsibility of bank managers and directors and the supervision of auditors, or to the control of the Reserve Bank, or to suitable provisions in the memorandum and articles of association of banks according to their needs. Nevertheless, certain matters must be provided

1 *Cf.* Bengal Committee Report, p. 222.

for by legislation which, although incapable of preventing mismanagement or fraud, will ensure a minimum standard of efficiency and integrity in the conduct of the business of banks. The Central Banking Committee, therefore, recommended that a special Bank Act should be passed comprising the provisions of the Indian Companies Act, with certain modifications and additions, and that even foreign banks should be brought under its operation to a certain extent.

The Foreign Experts, however, expressed a preference for the improvement of the Indian Companies Act itself, especially of its provisions relating to banks, on the grounds that it would not hamper useful activities of banks, that special banking legislation was a real protection, that numerous banks had continued to fail in the U.S.A. in spite of such legislation, and that, if it was evaded, or if it did not prevent bank failure and mismanagement, it was liable to reduce respect for law among the population.[1]

3. *Provisions of the Indian Companies Amendment Act* 1936 *relating to Banks.*—The Government of India and the Central Legislature did not accept the Central Committee's recommendation of a special Bank Act, and agreeing with the Foreign Experts, included a few provisions relating to banks in the Indian Companies Amendment Act 1936. They were as follows :—

(1) A banking company was defined as a company which carried on as its principal business the accepting of deposits of money subject to withdrawal by cheque, draft or order, notwithstanding that it engaged in addition in one or more of the following forms of business, *viz.*

(a) borrowing or lending of money, dealing in bills of exchange, promissory notes, stock exchange securities, railway receipts, etc., dealing in bullion and specie, and collecting and transmitting of money and securities;

(b) acting as agents for Government, local authorities or any person and the carrying on of any agency business other than the business of managing agent;

(c) contracting for public and private loans and negotiating and issuing the same;

(d) the promoting, guaranteeing, or underwriting of any issue of State, municipal or other loans, or of shares and debentures of any company;

[1] See their Report, Central Committee Report, pp. 628 and 657.

(e) transacting every kind of guarantee and indemnity business;

(f) promoting or financing any business undertaking ;

(g) dealing in any property, movable or immovable, and any rights or privileges, which come into possession of the banking company in satisfaction of claims or as security for loans given;

(h) undertaking and executing trusts;

(i) acquiring shares in any other company having objects similar to those of the company;

(j) establishing and supporting institutions and funds calculated to benefit the employees of the company and subscribing to or guaranteeing moneys for benevolent objects;

(k) acquiring and maintaining any building necessary for the purpose of the company and selling, developing, leasing, mortgaging or otherwise dealing with the property and rights of the company;

(l) doing all such other things as were incidental or conducive to the promotion of the business of the company.

(2) No banking company could be registered under the Act unless its memorandum limited its objects to the carrying on of the business of accepting deposits of money along with some or all of the forms of business specified in (1) above.

(3) No banking company, whether incorporated in or outside India, could carry on any form of business other than those specified in (1) above. The Government was, however, empowered by the Act to specify any additional business which a banking company might lawfully carry on.

(4) No banking company could be managed by a managing agent other than a banking company.

(5) No banking company registered under the Act could commence business, unless shares had been allotted to yield at least Rs. 50,000 as working capital, and unless a declaration signed by the directors and manager of the company that this amount had been received, had been filed with the Registrar.

(6) No banking company could create any charge on its unpaid capital.

(7) Every banking company, except a scheduled bank of the Reserve Bank, must maintain a reserve fund from the commencement of the Act and transfer to it not less than 20 per cent. of its annual declared profits before any dividend was declared, until the reserve fund was equal to the paid-up capital. The

reserve fund must be either invested in Government or Trust securities or deposited in a special account opened in a scheduled bank of the Reserve Bank.

(8) Every banking company, other than a scheduled bank of the Reserve Bank, must maintain by way of cash reserve a sum equal to at least 1½ and 5 per cent. of its time and demand liabilities respectively, and must file with the Registrar every month a statement of the liabilities borne and cash reserve held on Friday of each week of the preceding month. If a default was made in maintaining the required cash reserve or in filing the required statement, every director or officer of the bank who was knowingly a party to the default was made liable to a fine for every day during which the default continued.

(9) A banking company must not form, or hold shares in, any subsidiary company except a subsidiary company of its own formed for the purposes set forth in (1) above.

(10) A court of law might on the application of a banking company, which was temporarily unable to meet its obligations, accompanied by a report of the Registrar on the financial condition of the company, make an order staying the commencement or continuance of all proceedings against the company for a fixed period on such conditions as it might think fit, and might from time to time extend the period. The court might, for sufficient reasons, grant interim relief, even if the application was not accompanied by a report of the Registrar.

The following provisions of the amending Act applied to all companies, including banking companies :—

(1) Any persons indebted to a company must not be appointed its auditors, and if any persons, after being appointed auditors of a company, became indebted to it, their appointment must be terminated. The auditors of a company were entitled to attend its general meeting to which accounts examined by them were to be submitted and to make any statement that they might desire with respect to the accounts. If any auditor's report was made which did not comply with the requirements of the Act, every auditor, who was knowingly a party to the default, was made punishable with a fine up to Rs. 100.

(2) Every company must keep an index of the names of its shareholders and attach it to the register of its shareholders.

(3) The form F, in which every company had to supply its balance-sheet to its members and the Registrar of Joint-Stock

companies, was made more detailed, showing separately loans made to the directors, managers and other officers of the company, investments in Government and other trust securities, fully and partly paid shares or debentures of other companies, shares or debentures of subsidiary companies and immovable properties, and debts considered good and those considered doubtful or bad. The mode of valuation of the investments, *viz.* cost or market value, had to be stated. The previous distinction between secured and unsecured debts was retained. Every company must display in its office a copy of the statement of its financial position in the form G, which is more condensed than the form F, together with a copy of its last audited balance-sheet in the Form F. Every company, incorporated outside India and having an office in India, had to display a copy of the statement in the form H which was more condensed than the form F.

(4) If the directors of a company refused to register a transfer of any shares, they must within two months after the lodging of the transfer, send notices of the refusal to the transferor and the transferee.

4. *Proposals of the Reserve Bank of India for an Indian Bank Act and further Amendments of the Companies Act.*—In 1939 the Reserve Bank submitted a draft bill to the Government of India for the following reasons :—(1) Bank failures in South India had drawn the public attention to the necessity of stricter legislative control over banks. (2) A majority of non-scheduled banks were not providing the returns or maintaining the cash balances required by the Indian Companies Amendment Act 1936, on the ground, upheld by the courts, that they did not fall within the definition of banking companies set out in the Act.

(3) The Act did not provide sufficient deterrents for those banks which were in real difficulty, and it was in such cases that the interests of the depositors required to be specially protected.

(4) The Act allowed companies registered before the beginning of 1937 to call themselves banks, even if they did not conduct banking business as defined in the Act, and to refuse to comply with its provisions relating to banks.

(5) The services rendered by the smaller non-scheduled banks to Indian trade and industry were small as compared with the risks to which they exposed the credit structure of India, owing to their vulnerability under adverse conditions, caused by the

following drawbacks in their organization and working:—(a) their capital structure was too small; (b) most of them had poor reserve funds, as the bulk of their net profits were distributed as dividends; (c) many of them were really money-lending institutions operating on long-term deposits rather than banks operating on current accounts; and (d) they utilized most of their funds in loans and advances, which had a ratio of 86 per cent. to deposits, and a considerable portion of which was unsecured, and had very small investments in gilt-edged securities.

The Government of India, however, decided that the question of undertaking comprehensive banking legislation should be held over until after the War, and that in the meanwhile interim measures involving the minimum of legislation should be carried out to improve the administration of that part of the Indian Companies Act which related to banking, Accordingly, an amendment of the Act made in 1942 provided that any company, which used the word bank, banker or banking as part of its name must be deemed to be a banking company, irrespective of whether the business of accepting deposits of money on current account or otherwise subject to withdrawal by cheque or order, was its principal business or not. Further amendments, made in 1944, were as follows :—(1) A bank was prohibited from employing a managing agent, or any person whose remuneration or part of whose remuneration took the form of commission or a share in the profits of the company, or any person having a contract with the bank for its management, for a period exceeding 5 years at a time. (2) The following restrictions were imposed on a bank incorporated after 15th January 1937 :—(a) The subscribed capital must not be less than half the authorized capital and the paid-up capital not less than half the subscribed capital. (b) The capital must consist of ordinary shares only, or ordinary and such preference shares as were issued before 1st July 1944. (c) The voting rights of all shareholders must be strictly in proportion to the contribution made by the shareholders to the paid-up capital. In order to give the existing banks time to comply with the restrictions, they came into force from 1st July 1946. At first, it had been decided to postpone the above legislation until after the end of the War, in view of its controversial nature, but the following experience showed its urgency :—(1) A majority of the banks, started

recently, had inadequate paid-up capital. (2) Some of these banks had issued preference and deferred shares in addition to ordinary shares, giving preference shareholders no voting rights, distributing deferred shares of a low nominal value among the promoters and giving them the same voting rights as the holders of ordinary shares of many times the value of the deferred shares, and calling up only a small amount of the nominally large value of ordinary shares, so as to ensure a controlling voice in the management to an individual or a small group. These devices were dangerous not only to the preference and ordinary shareholders, but also to the depositors, because they provided a strong temptation to the management to indulge in unsafe or speculative business. (3) The provision of the law, prohibiting a bank being managed by a managing agent other than a bank, had been evaded by enterprising individuals, who had started banks and got themselves appointed as their managing directors, with agreements with them for 20 years, ensuring themselves high salaries, allowances and a percentage of profits, after the banks had declared a specified and low dividend.

5. *Bill to consolidate and amend the law relating to banking companies.*— The Government of India introduced this bill in the Central Legislative Assembly at the end of 1944, as it came across several undesirable features in the organization and management of some of the new banks, which had come into existence in a large number on account of the stimulus provided by war conditions. As it lapsed in 1945 owing to the dissolution of the Assembly, in March 1946 a revised bill was introduced in the Central Legislative Assembly and referred to a Select Committee of the Assembly. It was re-introduced in the Indian Parliament in March 1948 and was passed in 1949 with the following provisions, which are in addition to or in amendment of those of the Indian Companies Act :—

(1) Banking is defined as the accepting of deposits repayable on demand or otherwise. This will remove the difficulties created by the definition given in the Amending Act of 1936 that a banking company is a company which carries on as its principal business the accepting of deposits. (2) No company, after the expiry of two years from the commencement of this Act shall carry on the business of Banking unless it uses as part of its name at least one of the words 'bank', 'banker' or 'banking'. Every company, which uses as part of its name one of these words,

shall be subject to the provisions of this Act. No company other than a banking company shall accept deposits repayable on demand. (3) No banking company shall directly or indirectly engage in any trade or buying or selling of goods, otherwise than in connection with bills of exchange received for collection or negotiation. (4) If in satisfaction of its claims in the course of its banking business, any bank acquires assets, in which it is not lawful for it to transact business, it shall dispose of such assets within 7 years. (5) No banking company shall employ, or be managed by, a person whose remuneration is on a scale disproportionate according to the normal standards prevailing in banking business to the resources of the company, or whose remuneration takes the form of commission or of a share in the profits of the company, or who is a director of any other company, or is engaged in any other business or vocation, or has a contract with the company for its management for more than 5 years at any one time.

(6) (A) No banking company in existence on the commencement of the Act shall after the expiry of 3 years from the commencement of the Act, or such further period not exceeding one year, as the Reserve Bank having regard to the interests of the depositors of the company may allow, carry on business in any State of India, and no other banking company shall after the commencement of the Act commence or carry on business in India unless it has a paid-up capital and reserve of not less than, in the case of a banking company having its principal place of business elsewhere than in a State of India, Rs. 15 lakhs plus, if it has any place of business in Bombay City or Calcutta or both, Rs. 5 lakhs ; or in any other case (i) if it has places of business in more than one State Rs. 5 lakhs plus, if it has any place of business in Bombay City or Calcutta or both, Rs. 5 lakhs; (ii) if it has all its places of business in one State and has no place of business in Bombay City or Calcutta, Rs. 1 lakh in respect of its principal place of business, plus Rs. 10,000 in respect of each other place of business in the district in which it has its principal place of business, plus Rs. 250,00 in respect of each place of business situated elsewhere in the State, so however that no banking company to which this clause applies shall be required to have more than Rs. 5 lakhs as paid up capital and reserve; provided that a banking company, to which this clause applies and which has only one place of business, shall not be required to have more than Rs. 50,000 as paid-up capital and reserve; (iii) if it has all its places

of business in one State and has one or more places of business in Bombay City or Calcutta, Rs. 5 lakhs plus Rs. 25,000 in respect of each place of business outside Bombay City or Calcutta, so however that no banking company to which this clause applies shall be required to have more than Rs. 10 lakhs as paid-up capital and reserve: Explanation :—A place of business situated in a region or state other than that in which the principal place of business is situated, shall, if it is not more than 25 miles from that principal place of business, be deemed to be situated within the same region or State, as that principal place of business.

(B) A banking company incorporated elsewhere than in a State of India shall be deemed to have complied with the provisions of sub-section (A) only if it keeps deposited with the Reserve Bank an amount not less than the amount required in its case under that sub-section either in cash or in unencumbered approved securities or partly on both and such amount shall, in the event of the company ceasing to carry on business in the States of India, be an asset of the company, on which the claims of all its creditors in the States of India shall be a first charge.

(7) The subscribed capital of a banking company shall not be less than one half of its authorized capital and its paid-up capital shall not be less than one half of its subscribed capital.

(8) The voting rights of any one shareholder of a banking company shall not exceed 5 per cent. of the total voting rights of all its shareholders. (9) No banking company shall make any loans or advances on the security of its own shares or grant unsecured loans or advances to its directors or firms or private companies in which it, or any of its directors, is interested. (10) No banking company shall pay any dividend on its shares until all its capitalized expenses have been completely written off. (11) No banking company shall have as a director any person who is a director of another banking company. (12) Provision (7) of the Companies Amendment Act of 1936 mentioned before is made applicable to all banks incorporated in India. (13) The cash reserve of 1½ per cent. against time liabilities provided by (8) of the Act of 1936 is raised to 2 per cent.

(14) No banking company shall pay by way of commission, brokerage or discount, in respect of any shares issued by it an amount more than 2½ per cent. of the paid-up value of that share.

(15) (A) A banking company shall not form any subsidiary company for any purpose other than the conduct of executor or trustee business or such other purposes as are incidental to banking business. (B) Subject to (A) a banking company shall not hold shares in any company of an amount exceeding 30 per cent. of the subscribed share capital of that company or 30 per cent. of its own subscribed share capital and reserves, whichever is less. A banking company shall not hold shares of any company, in the management of which its manager is interested.

(16) (A) Every banking company existing at the commencement of this Act, before the expiry of six months, and every other company, before commencing banking business in any State of India, shall apply to the Reserve Bank for a licence. (B) Except that a banking company existing at the commencement of this Act may continue to carry on banking business in any State of India until it is granted a licence or is by notice informed by the Reserve Bank that a licence cannot be granted to it, no company shall commence or carry on banking business in any State of India, unless it holds a licence granted by the Reserve Bank : Provided that the Reserve Bank shall not give the above notice to a banking company in existence on the commencement of the Act before the expiry of the 3 years mentioned in section 6 (A) or of such further period as the Reserve Bank, under that section, may think fit to allow.

(C) Before granting a licence, the Reserve Bank may require to be satisfied by an inspection of the books of the company or otherwise that all or any of the following conditions are fulfilled, namely :—(a) that the company can pay its depositors in full as their claims accrue; (b) that the affairs of the company are not being conducted to the detriment of the interests of its depositors; (c) that the Government or law of the country, in which the company is incorporated, does not discriminate in any way against banking companies registered in a State of India and that the company complies with all the provisions of this Act applicable to banking companies incorporated outside a State of India. (D) The Reserve Bank may (a) cancel any licence on the breach of any of the above conditions required by it to be fulfilled ; or (b) at any time after granting a licence, require that any of the above conditions, on the fulfilment of which it did not require to be satisfied before, shall be fulfilled within a specified time, and if the condition is not so fulfilled,

cancel the licence. (E) No banking company shall open a new branch or change the location of an existing branch without the prior permission of the Reserve Bank, which may require to be satisfied that the public interest will be served by the opening of the branch or by the change in its location.

(17) (A) After the expiry of 2 years from the commencement of the Act, every banking company shall maintain in cash, gold or unencumbered approved securities, valued at the current market price, an amount not less than 20 per cent. of its time and demand liabilities in the States of India. (B) All deposits kept by a bank with the Reserve Bank shall be included in the above amount. (C) Every banking company shall, not later than 15 days after the end of each month, furnish to the Reserve Bank a monthly return in the prescribed form, showing its liabilities and assets, on each Friday during the month. (18) (A) At the close of each quarter, the assets in all the States of India of every banking company shall not be less than 75 per cent. of its time and demand liabilities therein. (B) Every banking company shall within one month from the end of every quarter submit to the Reserve Bank a return in the prescribed form of such assets and liabilities as at the close of the last working day of the previous quarter. (C) Such assets shall be deemed to include such promissory notes and bills of exchange as the Reserve Bank is empowered to discount and export bills drawn in India and expressed in such currencies as are approved by the Reserve Bank.

(19) (A) Every banking company shall, before the close of the month succeeding that to which it relates, submit to the Reserve Bank a return in the prescribed form showing its assets and liabilities in all the States of India at the end of every month. (B) The Reserve Bank may require a banking company at any time to furnish it with any information relating to its business. (20) At the end of each calendar year, every banking company incorporated in a State of India, in respect of all business transacted by it, and every banking company incorporated outside the States of India, in respect of all business transacted in the States of India shall prepare with reference to that year a balance-sheet and profit and loss account in the forms set out in the schedule, shall get them audited by a certified auditor and shall furnish three copies thereof to the Reserve Bank.

(21) Every banking company, incorporated outside the States of India shall display in each of its offices in the States of India a copy of its last audited balance-sheet and profit and loss account. (22) (A) The Reserve Bank at any time may, and on being directed by the Union Government shall, inspect any banking company and its books and accounts; and the Reserve Bank shall supply to the banking company a copy of its inspection report. (B) The Reserve Bank shall, if directed by the Union Government to inspect, and may in any other case, report to the Union Government on any inspection and the Union Government, if it is of the opinion, after considering the report, that the affairs of the banking company are being conducted to the deteriment of the interests of its depositors, may (a) prohibit the banking company from receiving fresh deposits, or (b) direct the Reserve Bank to apply for its winding up.

(23) (A) The Reserve Bank may (a) caution banking companies generally or any particular banking company against entering into any transactions and give advice; (b) assist in proposals for the amalgamation of banking companies subject to (25) below; and (c) after it has inspected a banking company, order the company to call a meeting of its directors for considering matters arising out of such inspection and to make such changes in its management as the Reserve Bank may consider necessary. (B) The Reserve Bank shall make an annual report to the Union Government on the trend and progress of banking in the country with particular reference to its own activities and make suggestions for the strengthening of banking business throughout the country. (C) The Reserve Bank shall appoint such staff at such places as it considers necessary for the scrutiny of the returns and information furnished by banking companies and generally for ensuring the efficient performance of its duties.

(24) If any banking company fails to comply with provisions (17) and (18), the Reserve Bank shall by notice in writing, make a demand to the banking company to comply with the provisions within 30 days and if the company fails to do so, the Reserve Bank shall apply to the court for the winding up of the company. (25) Provision 10 of the Indian Companies Amendment Act 1936 regarding the staying of proceedings against a banking company is modified by limiting the total period of moratorium to six months and requiring a report of the Reserve Bank, instead

of that of the Registrar, that in its opinion the company will be able to pay its debts if the application of the company is granted. (26) Without prejudice to provision (25) the court shall order the winding up of a banking company, if it is unable to meet any lawful demand for payment within two working days at any of its offices located at places where the Reserve Bank has offices or agencies and within four working days at any of its offices elsewhere, or if the Reserve Bank applies to the court for the winding up on either of the following grounds:—(a) that it appears from the results of an inspection that the affairs of the company are being conducted to the detriment of the interests of its depositors, or (b) that the company has failed to comply with provisions (17) and (18) mentioned above and with a notice served upon it as provided in (24) above. (27) The Court shall not make any order staying the proceedings for the winding up of any company, unless it is satisfied that an arrangement has been made whereby the company can pay its depositors in full as their claims accrue. (28) The Reserve Bank shall be appointed as the official liquidator relating to the winding up by Court of a banking company and shall submit a preliminary report to the Court within two months, to enable the Court to order the payment of a preliminary dividend. (29) The Court may dispense with any meetings of creditors or the appointment of a committee of inspection, to avoid delay and expense. (30) No banking company may be voluntarily wound up unless the Reserve Bank certifies that the company is able to pay in full all its debts to its creditors as they accrue and the Court shall, on the application of the Reserve Bank, order the winding up of the company, by the Court, if at any stage during the voluntary winding up, the company is not able to meet such debts.

(31) No banking company shall, except with the previous consent of the Reserve Bank, amalgamate or enter into any arrangement with any other banking company and the Reserve Bank shall not give its consent to the above unless it is reasonably satisfied that after the amalgamation or arrangement, all the debts of the banking companies concerned will be paid as they fall due. (32) (A) Whoever in any return or document required under the Act wilfully makes a statement false in any material particular, or wilfully omits to make a material statement, shall be punishable with imprisonment up to three years and shall also be liable to fine. (B) If any person refuses to produce any book or to answer any question in connection with

an inspection by the Reserve Bank under section (21) above, he shall be liable to a fine up to Rs. 500 for each offence and to a further fine up to Rs. 50 per day, if the offence continues. (C) If any deposits are received by a banking company in contravention of an order under (22) (B), every director or other officer of the company, unless he proves that the contravention took place without his knowledge or in spite of his due diligence, shall be punishable with a fine up to twice the amount of the deposits so received. (D) If any other provision of this Act is contravened, every director and other officer of the banking company, who is knowingly a party to the contravention, shall be punishable with a fine as mentioned in (B) of this section.

(33) (A) The Union Government may, on a representation made by the Reserve Bank, suspend for a period not exceeding 60 days, the operation of all or any of the above provisions either generally or in relation to any specified banking company. (B) In a case of special emergency, the Governor of the Reserve Bank, or in his absence a Deputy Governor, may act in like manner, for not more than 30 days and if he does so, shall report the matter to the Union Government forthwith. (C) The Union Government may extend from time to time the period of the above suspension for such period, not exceeding 60 days at any one time, as it thinks fit, and not exceeding one year in the aggregate.

(34) The Union Government may extend this Act to any acceding State for which the Union Legislature has the power to make laws in respect of banking companies. (35) The Union Government on being satisfied that any acceding State has enacted a law satisfying the prescribed conditions may by notification confer upon a banking company incorporated in that State and carrying on business in any State of India, the same rights and obligations under this Act, as if it were incorporated in a State of India. (36) References to the States of India shall be construed as including references to the acceding States to which the Banking Companies Act 1948 extends.

Temporary exemptions from some of the above provisions were granted from time to time by the Reserve Bank, as authorized, either to all banks or to some of them, to enable them to function smoothly. The above Act is open to the following criticisms :—
(1) It does not regulate the operations of indigenous bankers.
(2) The liquid assets should include the deposits of the smaller

banks with the scheduled banks. (3) 75 per cent. of the assets should be kept in India at the end not merely of each quarter but also of every week.

The Banking Companies (Amendment) Act, 1950 contains the following provisions:

1. No banking company shall be amalgamated with another banking company, unless a scheme containing the terms of such amalgamation has been placed before the shareholders of each of the banking companies concerned separately and approved by a resolution passed by a majority representing two-thirds in value of the shareholders of each of the said companies, present either in person or by proxy at a meeting called for the purpose.

2. Any shareholder, who has voted against the scheme of amalgamation at the meeting or has given notice in writing that he dissents from the scheme of amalgamation, shall be entitled, in the event of the scheme being sanctioned by the Reserve Bank, to claim from the banking company concerned, in respect of the shares held by him in that company, their value as determined by the Reserve Bank.

3. If the scheme of amalgamation is approved by the required majority of shareholders, it shall be submitted to the Reserve Bank for sanction and shall, if sanctioned by the Reserve Bank, be binding on the banking companies concerned and also on all the shareholders thereof.

4. The High Court shall have full power to decide all claims made by or against any banking company and all other questions which may arise in the course of the winding up of a banking company.

5. There shall be a right of appeal from every order made by a High Court under the above provision.

6. Subject to the right of appeal, every above order of a High Court shall be final and binding.

The above Act was passed to secure a speedy amalgamation of banking companies and a speedy disposal of proceedings for the winding up of banking companies.

The important features of the Banking Companies (Amendment) Act, 1953, which was passed for expediting the proceedings for the liquidation of banks ordered to be wound up, are as follows :—

1. The jurisdiction of the High Court has been extended with a view to avoiding multiplicity of courts to which the liquidator of a banking company has to follow his debtors.

2. A summary procedure has been laid down for the realization of the outstanding debts of a banking company with a view to obviating multiplicity of proceedings, one of the chief causes for delay and expenses of liquidation.

3. Provision has been made for expeditious enforcement of the liability of the directors by providing for the compulsory public examination of their conduct in relation to the affairs of the banking company.

4. Special provision has been made that in all proceedings against any promoter, director, manager, or officer of a banking company for repayment or restoration of any money or property, once a *prima facie* case is made against any of them by the liquidator, the High Court shall make an order against such person to repay and restore the money or property unless he proves that he is not so liable.

5. The Union Government has been empowered to appoint court liquidators in the High Courts who will be in charge of the liquidation of all banking companies ordered to be wound up.

6. Provision has been made for expediting an execution of orders and decrees passed against debtors of banking companies.

The important features of the Banking Companies (Amendment) Act, 1956 are as follows :—

1. The exemption granted to banking companies incorporated before 15th January 1937 from the limitation of the voting rights of any one shareholder to 5% of the total voting rights of the shareholders of a banking company is withdrawn.

2. No banking company incorporated in India shall have as a director any person who is a director of companies, which among themselves are entitled to exercise voting rights in excess of 20% of the total voting rights of all the shareholders of the banking company.

3. Where the Reserve Bank is satisfied that (a) in the national interest, or (b) to prevent the affairs of any banking company being conducted in a manner prejudicial to the interests of the banking company, or (c) to secure the proper management of any banking company in general, it is necessary to issue directions to banking companies generally or to any banking company in particular, it may, from time to time, issue such directions as it deems fit, and the banking companies shall be bound to comply with such directions.

4. In the case of a banking company, no amendment of any provision relating to the appointment or re-appointment or remuneration of a Managing Director or a Manager or a Chief Executive Officer, shall have effect unless approved by the Reserve Bank and no appointment or re-appointment of a Managing Director, Manager or Chief Executive Officer, shall have effect unless it is made with the previous approval of the Reserve Bank.

5. During or after the inspection of a banking company the Reserve Bank may appoint one or more of its officers to observe the manner in which the affairs of the banking company are being conducted and make a report thereon; and may require the banking company to make such changes in the management as the Reserve Bank may consider necessary in consequence of the state of affairs disclosed by the inspection.

6. Every Chairman, Director, Manager or any other employee of a banking company shall be deemed to be a public servant for the purposes of chapter IX of the Indian Penal Code dealing with illegal gratification.

The Banking Companies (Amendment) Act 1959 has the following important provisions :—

(1) Banking companies, with the previous permission of the Reserve Bank, can form subsidiary companies for carrying on banking business exclusively outside India.

(2) The Reserve Bank can remove from office the Chairman, or any director or chief executive officer of a banking company, of he is found by any tribunal or authority (other than a criminal court) to have contravened the provisions of any law and the Reserve Bank is satisfied that his association with the bank is undesirable. It can also prohibit him from taking part in the management of any bank for such period not exceeding 6 years as the Bank may think fit.

(3) No amendment of any provision relating to the appointment or re-appointment or remuneration of a director of a bank shall have effect unless approved by the Reserve Bank.

(4) The Reserve Bank can inspect the foreign branches and subsidiaries of Indian banks.

(5) The Reserve Bank can apply to the court for the winding up of a bank under certain circumstances mentioned in the Act.

(6) No bank can be voluntarily wound up unless the Reserve Bank certifies that the bank is able to pay in full all its debts to its creditors as they accrue.

(7) No bank can change its name or its memorandum without the previous approval of the Reserve Bank.

The Banking Companies (Amendment) Act 1960 protects banks from being compelled to disclose their inner reserves to the Tribunals and other authorities constituted under the Industrial Disputes Act and empowers the latter to call for certificates from the Bank regarding the amount of such reserves, as may be taken into account for the purposes of the proceedings under the Act, after the Bank has examined the financial position of the banking company concerned.

The Banking Companies (Second Amendment) Act 1960 has the following important features :—

(1) Preferential payment should be made to the secured creditors of a bank in liquidation within 3 months from the date of the winding-up order. Thereafter, every savings bank depositor of the bank should be paid the balance at his credit subject to a maximum of Rs. 250. After that, every other depositor of the bank should be paid Rs.250 or the balance to his credit, subject to a maximum of Rs. 250. The total amount to be paid in this way to a depositor, having more than one type of account, should not exceed Rs. 250.

(2) The Reserve Bank can apply to the Central Government for an order of moratorium in respect of a bank. The Central Government, thereupon, may grant moratorium upto a period of six months. During the period of moratorium, the Bank may prepare a scheme for reconstruction of the banking company or its amalgamation with another banking company, and submit it to the Central Government which may sanction the scheme, with modification, if necessary. The scheme as sanctioned would be binding on the banking companies concerned and also on all their members and creditors.

The Banking Companies (Amendment) Act 1961 empowers the Reserve Bank to prepare a scheme for the compulsory amalgamation of any banking company with the State Bank of India or its subsidiaries. It also permits the amalgamation of more than two banking companies under a single scheme. Any amalgamation proposed under this scheme is binding not only on the concerned banking companies, their members and creditors, as provided earlier, but also on their employees and other persons possessing any right or liability in relation to such banking companies. The Act authorizes the Central Government to sanction such a scheme with modification, if necessary.

6. *Strengthening the capital funds and liquidity ratio of banks.*—Although the deposits as well as profits of commercial banks had increased substantially in the last decade, they paid little attention to the building up of adequate capital funds *i.e.* paid-up capital and reserves. The result was that the percentage of capital funds to the deposits of scheduled banks diminished from 9 in 1950 to 4 in 1960. This was due to the fact that the provisions of the Banking Companies Act, 1949 regarding capital and reserves were of a minimal nature, for raising the standard of performance of a large number of marginal banks and did not require the banks to build up their reserves or to increase their capital beyond a certain minimum. Reserves provide a cushion to meet unforeseen contingencies and should have some basic relation to deposits or risk assets of banks. Further, banks must have a strong capital position for venturing into new activities such as medium-term loans and loans to small industries. By 1960, the Reserve Bank realized the necessity of banks taking steps to build up their capital and published and inner reserves out of their annual net profits, as well as raising their capital through fresh issues of shares.

In 1961, as the result of discussion between the Reserve Bank authorities and the representatives of the Indian Banks' Association it was agreed that by convention, in preference to legislation, all banks would transfer at least 20 percent of their annual disclosed profits to their published reserves until the reserves together with the paid-up capital formed at least 6 per cent. of their total deposits. But in 1962, it was realized that those banks, which were not members of the Indian Banks' Association, might not honour the convention. Therefore, Section 17 of the Banking Companies Act 1949 has been amended to provide that a bank incorporated in India shall have to contribute to its reserve fund 20 per cent. of the annual disclosed profit, regardless of whether its reserve fund together with its share premium account equals its paid-up capital; and that the Central Government may, on the recommendation of the Reserve Bank and having regard to the adequacy of the paid-up capital and reserves of a bank in relation to its deposit liabilities, declare by order in writing that it need not make further contributions for such period as may be stated in the order.

Amendment of Section 11 of the Banking Companies Act has provided that a bank incorporated outside India shall deposit with the Reserve Bank every year 20 per cent. of its profits from Indian branches, in addition to a deposit with the Reserve Bank

of an amount of Rs. 15 lakhs or Rs. 20 lakhs, if it has a place of business in Bombay or Calcutta, or both; and that the Central Government may, on the recommendation of the Reserve Bank, exempt the above bank from further deposit of 20 percent. of the annual profits of its Indian branches, if the Government considers the amounts already deposited by the bank to be adequate.

As regards the liquidity ratio *i.e.* percentage of cash, balances with the Reserve Bank, gold and unencumbered securities to total deposit liabilities of scheduled banks, excluding the State Bank of India, the Reserve Bank pointed out in 1961 that it had declined from 43.3 in 1951 to 33.1 in 1961; that the percentage of cash and balances with the Reserve Bank, of scheduled banks had declined from 11.1 to 7.5 in the same period; that, in the years to come, with the continuous growth of the economy, particularly of the industrial sector, there was likely to be a further rapid rise in bank credit, which might outpace the growth in deposits, resulting in further pressure on the liquidity of banks; and that, in such a situation, it was essential to safeguard the soundness of the banking system by raising the minimum liquidity ratio, which might also stimulate the banks to mobilize their deposit resources more effectively to meet expanding credit needs.

Hence, the Reserve Bank proposed that the minimum cash reserve to be maintained by banks under the law would be 5 per cent. of their total deposits instead of the prevailing 5 and 2 percent. of their demand and time liabilities respectively and that the minimum liquidity ratio *i.e.* percentage of cash balances with the Reserve Bank, gold and unencumbered securities would be 27½ per cent. of the deposits instead of the prevailing 20 per cent. Later, the Reserve Bank made its attitude more stiff by proposing that the minimum cash reserve would be 5 per cent. of the total liabilities and not total deposits and that the liquidity ratio should be 29 per cent. Ultimately as the result of representations made by the Indian Banks' Association, the Reserve Bank agreed to reduce the percentages to 3 and 28 and the Reserve Bank of India Act and the Banking Companies Act were amended accordingly.

7. *Deposit Insurance Corporation Act.*—In 1954 the Shroff Committee had recommended the formation of a scheme of insurance of bank deposits for protecting the depositors, inspiring public confidence in the banking system, reducing the occurence of panicky withdrawal of deposits from banks, assisting in the active development of the banking habit of the community,

facilitating the mobilization of a larger volume of deposits, particularly in the rural areas and generally contributing to the stability and orderly growth not only of individual banks, but also collectively of the banking system. The failure of two scheduled banks in 1960, one of which had a considerable amount of deposits, rendered the need for such a scheme urgent. Hence, the Deposit Insurance Corporation Act was passed in 1960 and the Corporation was set up at the beginning of 1961.

The Corporation has an authorized capital of Rs. 1 crore, fully paid up by the Reserve Bank. Its direction and management are vested in a Board of Directors consisting of the Governor of the Reserve Bank as Chairman, a Deputy Governor of the Reserve Bank, an officer of the Central Government nominated by it and two directors nominated by the Central Government in consultation with the Reserve Bank, who possess special knowledge of commerce, industry or finance but who are not officers of the Government, the Reserve Bank or a bank. The term of office of the non-official directors is limited to four years. The day-to-day affairs of the Corporation are entrusted to an Executive Committee constituted by the Board from among its members. The Corporation is guided by such directions in matters of policy as the Central Government, after consulting the Reserve Bank, may give to it.

All functioning commercial banks have to be registered as insured banks under the Act.

The amount of insurance cover provided by the Corporation is, for the present, fixed at Rs. 1500 in respect of each depositor in each bank, in the same capacity and in the same right. It is estimated that the present limit of insurance gives full protection to 4 out of every 5 depositors and that the insured deposits are about $\frac{1}{4}$ % of the total bank deposits. The Act enables the Corporation, with the previous sanction of the Central Government, to raise the limit of insurance from time to time.

Within three months from the date of winding up of a bank, the liquidator must furnish to the Corporation a list of depositors showing the deposits of the individual depositors, as well as the amounts set off, as between the depositors and the bank, if any. Within two months of the receipt of the list, the Corporation must make the payment to the depositors. The Corporation can reimburse itself for such payments from the assets of the insured bank. The maximum premium which the Corporation can charge

the insured banks is 15 nP per annum for every Rs. 100 of the total amount of deposits of the bank, excluding the deposits by Central and State Governments, a foreign Government or a bank, which are not insured. For the present, the Corporation has fixed the rate of premium at 5 nP per annum for every Rs. 100 of deposits *i.e.* at 1/20 of 1 percent. of deposits.

The Corporation has to maintain a separate Deposit Insurance Fund, to which all amounts of premium collected by it are added and from which payment of claims in respect of insured deposits must be made. Borrowings from the Reserve Bank, authorized by the Act upto Rs.5 crores, and repayments to it must be channelled through this Fund. In addition, the Corporation has to maintain a General Fund, built up with the capital and reserves as well as income accruing from the investment of this fund, after meeting the working expenses of the Corporation. If at any time the amount available in the former Fund is insufficient for its requirements, the Corporation can transfer to it amounts from the latter Fund, with the prior approval of the Reserve Bank.

The success of the above scheme depends largely upon proper supervision of the working of the insured banks and efforts on the part of the banks themselves for improving the standard of their operations. As all commercial banks are inspected periodically by the Reserve Bank, the Corporation does not have to inspect them separately. However, the Corporation can request the Reserve Bank to inspect an insured bank and to furnish a report to it. It can also ask the insured banks to supply it with any information regarding their deposits and examine their records.

Chapter XIV
SAVING AND INVESTMENT

1. *Their present position.*—The progress of banking in a community depends vitally upon the growth of saving and investment in it. The latter in turn depend on the saving capacity of the people, their will to save, and facilities for investment. The saving capacity of the agriculturists, who make up the larger portion of the Indian community, is small even in good years. The few well-to-do agriculturists, who can save substantially in good years, use their savings for the purchase of land or ornaments, or for money-lending operations. A large proportion of the landlords are said to be in financial difficulties. Moreover, their wealth,

consisting chiefly of land, cannot materially increase the resources of the capital market in India.

The salaried and professional sections of the middle class have been generally satisfied with a low but secure yield from their investments, and so have preferred deposits in post office savings banks or commercial banks, postal cash certificates, or Government securities to joint-stock securities. A large proportion of the well-to-do classes have shown a similar preference. The commercial classes have invested their savings to some extent in joint-stock securities, but also in short-term deposits in banks, and the purchase or mortgage of land and buildings. Very recently, however, the other classes also have begun to invest some of their savings in joint-stock securities.

Ornaments are still a very popular form of investment throughout the country. This is so, because they have always played an important part in social ceremonies sanctioned by religion or custom. Moreover, this preference was promoted by the absence of banking facilities, of facilities for safe investment, of quick realizability of other investments, and of security of property. The Hindu law of inheritance which until very recently made women ineligible for receiving any share of immovable property, has also led to the practice of giving *stridhan* to women in the form of ornaments at the time of marriage. However, with the growth of education, and the expansion of banking and investment facilities, this ancient custom of putting savings into ornaments has already commenced to decline and with the further growth of these favourable factors, combined with a widespread propaganda for turning ndividual savings to productive uses, the decline of this custom will be accelerated in the immediate future, making an increasing share of the community's savings available for increasing the resources of the Indian banking system.

2. *Suggestions for developing saving and investment.*—Although the hoards of wealth in the country are not large, the commercial and co-operative banks have already succeeded in tapping a proportion of them and of the current savings of the people. A substantial portion of both, however, still remain to be tapped and, therefore, it is necessary to conduct an extensive and systematic propaganda for promoting the saving and investment habit among the people, and to increase the facilities for investment. The Provincial and Central Banking Committees are confident that, if

this is done, the response of the people will be large and quick. They have, therefore, suggested the establishment of thrift and savings associations all over the country similar to the National Savings Associations in England. They will be able to develop the saving habit among persons of small means, to remove their timidity, and to make them familiar with safe yet paying investments, by systematic education and propaganda for small savings, by supplying means for their collection, and by pooling them for profitable investment in sound securities. Lessons on thrift and investment should also be included in school curricula, and home savings safes should be made available to the public by the above associations and by joint-stock and co-operative banks.

A substantial increase in the use of cheques is another indication of the expansion of the banking habit among the people of India. A large proportion of the people, however, cannot use cheques or understand the facilities and the security that they offer, owing to their ignorance of the English language. There is, therefore, a general demand for the use of scripts in Indian languages in the various fields of banking, including cheques, pass-books and paying-in-slips, and this reform will do much to expand the banking habit among the people. The State Bank or the Indian Banks Association should arrange a conference of all banks to decide upon the adoption of a common policy in this matter.

The banks should also endeavour to reduce the delay involved in cashing cheques, and should induce traders and merchants to use cheques as far as possible in the settlement of up-country market transactions in respect of the movement of crops. Further, they should provide adequate facilities for the transfer of funds from one centre to another, because the circulation of cheques in the money market and the mobility of banking resources depend much upon these facilities. Finally, Government should allow the payment of land revenue and other dues by cheques into district treasuries and taluka sub-treasuries in the same way in which it allows such payment at present into the branches of the State Bank, and it and local bodies should make all payments by cheques as far as possible.

In Chapter VI we have examined the scope for extending investment facilities by means of post office savings banks, postal cash certificates, purchase and sale of Government securities through post offices, and insurance companies.

The banks can increase the popularity of investment in securities, by lowering their charges to the public for the purchase and sale of these securities, and for the collection of interest or dividend, safe custody, and other services regarding them, and by offering favourable terms to the public for the purchase of newly issued securities in instalments.

As regards investment in industrial securities, although joint-stock companies offering a reasonable guarantee of good management and prospects do not have difficulty nowadays in securing the required capital, there is no regular investment market in India, except in the few largest cities, and investment banks, with an organization for examining the soundness of new industrial securities, and underwriting and marketing them, do not yet exist in the country. Such banks can help much in the establishment of sound companies, in promoting the sale of their securities, and in creating public confidence in such securities. Until such institutions are established on the lines indicated before, and more stock exchanges are brought into existence the existing banks should take up the purchase and sale of these securities for their clients on a commission basis.

The debentures issued by well-conducted companies enjoying a good standing and reputation are readily marketable at a good price, but their quantity is small and the demand for them is chiefly from a small class of investors, who want a little higher yield on their investments than that given by Government securities, but who are not prepared to go in for risky investments, such as the shares of companies.

Provident funds are very useful in promoting thrift and savings of employees. Until recently, the employees of Government, railways and other public bodies only enjoyed the benefits of these funds. But now they are being granted to the employees of charitable and educational institutions, and commercial and industrial concerns all over India. Very recently, legislation has made them compulsory for all factory workers belonging to certain industries. Some of the banks give special rates of interest on the deposit of these funds. They should give all possible help to ensure the success of such schemes. Provident or benefit societies, which collect small sums regularly from their members, hold them in safe investments, and give their benefit to the contributors in some form, have come into existence in some States. In Madras, several Nidhis and Chit Funds perform this function.

But difficulties have arisen owing to the absence of a definite legal regulation of such societies. An All-India Act, therefore, should be passed to regulate their working on the lines of the English Industrial and Provident Societies Act.

The Bengal, Central Areas and C.P. Committees have suggested the formation in India of investment trusts, on the lines of those which have proved so useful in England and the U.S.A., for promoting the saving and investment habit among the people. They act as intermediaries between the primary investors and the borrowing industries, secure adequate information regarding the prospects and working of the latter, watch their working continuously, and spread out the risks in various classes of investments far more effectively than the primary investors can do There are half a dozen investment companies in India, but all. of them cannot be regarded as investment trusts. Further the supply of safe securities should be increased by the issue of debentures by the land mortgage and industrial corporations and by investment trusts, and by the issue of debentures by industrial companies with the support, and under the guidance, of the industrial corporations and investment trusts.

Until recently Government borrowed from the savings of the Indian community without considering the effects of such borrowing upon private enterprise. As the volume and the rate of Government borrowing, owing to its greater security, affect the volume and rate of the savings available to banking, trade and industry, correlation between the capital needs of Government and private enterprise is necessary. So the Union and State Governments now borrow in consultation with the Reserve Bank. But they take away a major portion of the savings of the community for financing their numerous and large development projects.

With regard to rural savings, the Committee of Direction, Rural Credit Survey has expressed the view that the need to make rural savings possible by means of economic development and power credit expansion, is much more important than to render rural savings available by mobilization of different kinds; that rural savings are most likely to be rendered available where most seen to be used for rural needs; and that rural savings fall so short of rural needs that they must be supplemented from, not diverted to, urban areas.

For the promotion of rural savings, the Commitee has made the following recommendations :—

1. The primary credit society, the central bank, the central land mortgage bank and the marketing, processing and other societies should mobilize rural savings on a much larger scale than hitherto in the following ways :

(a) The larger sized primary credit societies should institute a 'Mutual Help Chit Fund'. Entry to the Chit Fund should be through nominal membership of the primary credit society itself and a third of the monthly contributions should be earmarked as fixed deposits made in the society by the nominal members.

(*b*) Until the share capital of co-operative organizations at the village, taluka and district levels reaches the optimum level, there should be a gradual compulsory increase in the shares of members, in some relation to their borowings, together with proportionate additions by Government. After the optimum level is reached there should still be a compulsory contribution of share capital by members alone until the whole of the Government share is retired in the case of primary societies and until the Government share is reduced to 51 per cent. in the case of societies above the primary level. This would be an important means of attracting savings from the members of all co-operative societies including those concerned with the production, processing, marketing and other activities of the villagers.

2. The Reserve Bank and the State Bank should take steps to encourage the market for 'rural debentures' that may be issued by land mortgage banks and later by central co-operative banks. These debentures should be issued for specific projects of development in which the villagers are interested and should be issued at the time of harvest and sale of crops. The Reserve Bank should give accommodation on such debentures as readily as on other forms of acceptable security.

3. In suitable areas, if not everywhere, the Reserve Bank and the State Bank should give free remittance facilities to co-operative banks.

APPENDIX 1

TABLE I

PER CAPITA DEPOSITS OF COMMERCIAL BANKS IN SELECTED COUNTRIES

(As at the end of December 1961)

Name of the country	No. of Commercial Banks.	No. of offices.	Deposits	Population (million)	Per Capita Deposits
1. U.S.A. ..	13,432	24,509	(million $) 242,100	183.6	$ 1,318.6 (Rs. 6,282.2)
2. U. K. ..	16	12,500	(million £) 25,000	52.6	£ 475.2 (Rs. 6,314)
3. Japan ..	87	5,839	(million yen) 10,332,426	94.0	Yen 109,919.4 (Rs. 1444.88)
4. W. Germany	361	3,252	(million DM) 40,068.1	56.4	DM 710.4 (Rs. 847.83)
5. Italy ..	505	8,966	(million lires) 11,914,443	49.5	Lires 240,695.7 (Rs. 1,853.0)
6. India ..	298	5,098	(million Rs.) 18,829.4	43.9	Rs. 42.9

TABLE II

CHANGES IN SOURCES AND USES OF SCHEDULED BANKS' FUNDS

	(In crores of rupees) 1962	1961
I. SOURCES		
(a) Increase in paid-up capital and reserves ..	6.5	1.3
(b) Increase in deposits (excluding P. L. 480) ..	232.8	167.8
(c) Increase in borrowings from Reserve Bank of India.	2.0	..
(d) Inflow of funds from abroad ..	4.8	..
(e) Reduction in cash and balance with Reserve Bank of India	23.1	13.6
(f) Reduction in investments (excluding P. L. 480) ..	..	..
	269.2	182.7
II. USES		
(a) Reduction of borrowings from Reserve Bank of India	....	42.8
(b) Outflow of funds abroad	..	8.2
(c) Increase in bank credit	146.5	105.9
(d) Increase in cash and balances with Reserve Bank of India	..	7.4
(e) Increase in Investments (excluding P. L. 480) ..	114.3	50.0
	260.8	214.3
III. ERRORS AND OMISSIONS	— 8.4	+31.6

TABLE III

PRINCIPAL LIABILITIES AND ASSETS OF SCHEDULED BANKS

(In crores of rupees)

As on last Friday of December	No. of Reporting Banks	Demand Deposits (excluding inter-bank deposits)	Time Deposits (excluding inter-bank deposits)	Aggregate Deposits	Aggregate Deposits (excluding P. L. 480/665 funds)	Borrowings from the Reserve Bank	Cash in hand and balances with the Reserve Bank	Percentage of (7) to (4)	Total Bank Credit	Percentage of (9) to (4)	Investments in Government securites.	Investments in Others	Total Investments (11 *plus* 12)	Percentage of (13) to (4)
	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1961	82	732.6	1,102.1	1834.7	1,696.5	18.7	155.8	8.5	1277.0	69.6 (75.3)	577.0	74.8	651.8	35.5
1962	79	816.9	1,222.0	2038.9	1929.3	20.7	132.7	6.5	1421.8	69.7 (73.3)	646.2	91.3	737.5	36.2

Figures in brackets indicate percentages to aggregate deposits excluding P. L. 480 and 665 funds.

Increase in deposits in 1962 created a record, being Rs. 233 crores. This was due to higher rate of deficit financing during 1962–63, strengthening of the banking structure by the compulsory merger of sub-standard banks with sound banks, setting up of the Deposit Insurance Scheme, important amendments to the Banking Companies Act for strengthening the liquidity and capital funds of banks, raising by banks of their rates of interest on time deposits, intensified drive by banks for mobilization of deposits by means of extension of ancillary services to customers and more intensified publicity campaigns and increase in the number of branches by 226 as compared to 246 in 1961. The demand and time deposits increased by Rs. 84 and 149 crores respectively. The greater rise in time deposits was mostly attributable to the higher rates of interest offered by banks on time deposits.

Both as a result of the satisfactory growth in deposits and the operation of the tier-rate system of lending by the Reserve Bank, scheduled banks reduced their borrowings from the Reserve Bank in 1962, the maximum borrowings being Rs. 66 crores in March 1962 as compared to Rs. 95 crores in March 1961.

From September 1960, the Reserve Bank tried to exercise general restraint on excessive credit expansion by banks and to curtail the less urgent demands through the slab system of lending rates, which raised the cost of borrowing from the Reserve Bank to a scheduled bank progressively with an increase in its borrowing from the Bank. Within this general framework, the Reserve Bank exercised selective credit controls to regulate the flow of bank credit in those sectors where it was likely to give rise to an undesirable increase in prices. In September 1961, the Reserve Bank had also directed the scheduled banks to increase their lending rates. All this resulted in reducing the dependence of scheduled banks on the Reserve Bank and in encouraging them to find more resources of their own by way of deposits, share capital and internal resources.

Of the 39 banks, which were granted moratorium till the end of 1962, 31 were amalgamated with other banks. There were voluntary amalgamations in the case of 3 banks and transfer of assets and liabilities in respect of 4 banks. Of the 9 minor State-associated banks, considered suitable for merger with the State Bank of India and its subsidiaries, the State Bank of India took

over the business of 5 banks and the State Bank of Indore of one bank. The State Bank of Bikaner took over the assets and liabilities of the State Bank of Jaipur.

The aggregate number of offices of both scheduled and non-scheduled banks increased during 1962 by 160 (to 5,271) as compared to only 84 in 1961. There were still as many as 1,018 towns out of a total number of 2,690 in the country (according to the 1961 Census) which were not served by any office of the commercial banks. According to the 1951 Census, the total number of towns without banking facilities had been stated to be 1,400. The number of offices actually opened at places which were not served by any banking office earlier was 47 in 1962 as against 58 in 1961. Of these, the State Bank of India accounted for 21 offices. During the year, 51 offices (116 in 1961) were closed, of which 20 belonged to scheduled banks.

Appendix II

NATIONALIZATION OF BANKS IN INDIA

Nationalization of joint-stock banks in India is being advocated recently by some persons inside and outside the Indian Parliament on the following grounds :—

(1) It will enable Government to obtain as its revenue all the profits of the banks at present amounting to about Rs. 35 crores.

(2) It will safeguard and promote the interests of depositors, which the shareholders and managements of the joint-stock banks are incapable of doing. This will promote the confidence of the public in the banks, thereby bringing about a rapid and very large increase in deposits.

(3) It will bring about a rapid increase in the number of banking offices in semi-urban and rural areas, as the banks will no longer be actuated by the motive of profit. This will enable the banks to mobilize quickly and adequately the resources of the nation for its defence and development. At present the joint-stock banks are unable to do so as they are reluctant to establish branches which cannot be expected to yield a profit at an early stage.

(4) It will remove the present heavy concentration of economic power in the hands of a few industrialists who manage the joint-stock banks in their own interests and through them have a great and strategic control over the national economy.

(5) It will enable the banks to employ their resources strictly in accordance with the priorities and requirements of planned economic development and national interest. It will prevent financing by banks of anti-social activities such as speculation and hoarding of essential commodities with a view to selling them later at higher prices.

(6) It will enable banks to give large financial help to the agriculturists and small industrialists of the country. The joint-stock banks are doing very little in this direction.

(7) It will replace the profit motive by service motive in the functioning of the banks, thereby helping greatly in the achievement of a socialist society. This will evoke a favourable response from all bank employees including officers and bring about much greater efficiency of operation and management.

(8) It will bring down the emoluments of the top executives of the banks, who are receiving much greater emoluments than their counterparts in the public sector.

Those who are not in favour of nationalization of banks in India, have given the following reply:[1]

Although revenue is an important consideration for all Governments, the Government of India would not nationalize any industry on this ground. It has made it clear in its Industrial Policy Resolutions that nationalization can be based only on the basic or strategic nature of an industry, its character as a public utility or its need for large investment of funds, which the private sector may not be able to provide. Further, the bank profits do not amount to Rs. 35 crores. According to the *Statistical Tables relating to Banks in India* for the year 1961, published by the Reserve Bank of India, the total profits earned during 1961 by all the commercial banks, Indian and foreign, scheduled and non-scheduled, including the State Bank of India and its subsidiaries, which are already nationalized banks, were only Rs. 28.80 crores.

Out of these profits, Rs. 14.45 crores, that is more than half, were already paid to the Government as taxes. Further, one-fourth of the profits were utilized for transfer to reserves (Rs. 3.59 crores) and for payment of bonus to employees (Rs. 3.26 crores). Out of the rest, only Rs. 4.61 crores, less income-tax on the dividends, were paid to the shareholders as dividends, the small balance

1 See a brochure entitled *Should Banking be a State Monopoly in India* published by the Indian Banks' Association.

(together with the sums brought forward from the previous year) being utilized for payment of gratuity to the employees in future years, other special purposes like donations etc. and carry forward to next year's accounts.

Even if the banks were nationalized, their reserves would have to be built up, bonus would have to be paid to their employees and other allocations would have to be made as before. The only additional benefit that would accrue to the Government revenue would be the amount of Rs. 4.61 crores less income-tax, paid out to the shareholders as dividend. But, this benefit would be offset by a burden of about Rs. 3 crores which the Government would have to pay annually to the shareholders as interest at a fair rate, say 4 per cent. on bonds which would have to be given to them as compensation for their capital funds, amounting to Rs. 76.36 crores. Hence, the net benefit to the Government would be less than Rs. 1.61 crores only and not Rs. 35 crores per annum, as misrepresented by the advocates of nationalization. The dividend, representing 16 per cent. of the total profits, gave hardly a 6 per cent. return to the shareholders on their capital funds amounting to Rs. 76.36 crores and consisting of paid-up capital amounting to Rs. 39.86 crores and accumulated reserves, amounting to Rs. 36.50 crores. The reserves also belong to the shareholders as they are undistributed profits retained in business after paying taxes on them. They, therefore, cannot be used for repaying the capital of the shareholders, if the banks are nationalized.

Although the paid-up capital and reserves of banks are small, they have been able to obtain large deposits from the public on account of the reputation for integrity, efficiency, hard work and farsightedness built up by their managements, consisting of the senior officers, under the direct control of the Boards of Directors. The Boards of Directors consist of men of eminence, varied experience and mature judgment, who have made their mark in various fields of life, such as industry, business and professions. They control the functioning of banks and see that they are run on sound lines in the interests of both the depositors, shareholders and the public. Further, since the establishment of the Deposit Insurance Corporation for protecting the deposits of banks up to Rs. 1,500 there is no force left in the argument that if banks were nationalized they would command greater confidence of the public and secure larger deposits from it.

Moreover, the Banking Companies Act gives the Reserve Bank of India and the Government extensive powers of inspecting,

controlling and directing the operations and administration of banks, in the interests of depositors as well as of the nation. These powers have been explained in the chapter on 'Regulation of Banking' and give ample protection to the depositors, the shareholders and the public.

Between 1951 and 1961, the number of bórrowers' accounts in the Indian banks increased from 3.8 lakhs to 12.3 lakhs. This shows that an increasing number of business and industrial borrowers have been able to take advantage of the credit facilities offered by the banks. It is, therefore, entirely incorrect to say that the Indian banks are dominated by small groups of big industrialists, who make the banks give a large portion of their advances to those concerns only, in which the industrialists themselves are interested. Moreover, there is no concentration of the advances of the banks, as a whole, in the hands of a few borrowers. The Reserve Bank has stated in its *Trend and Progress of Banking in India during* 1961 that in the case of 40 banks inspected by it, the concentration of advances in the hands of a few borrowers was 21 crores when the first inspection was completed by 1953, and Rs. 31 crores at the time of subsequent or latest re-inspection. But Rs. 21 crores was only 3.8 per cent. of the total advances of all banks amounting to Rs. 556 crores in 1953 and Rs. 31 crores was 2.3 per cent. of the total advances of all banks amounting to Rs. 1,346 crores at the end of 1961. The percentage has dropped considerably and is small in itself. Further, according to the same report, large advances to directors, their relations and associates and concerns in which any of them was interested in the case of 33 banks, which were inspected, amounted to Rs. 6 crores by the end of 1953 and Rs. 9 crores by the end of 1961. But Rs. 6 crores was only 1.1 per cent. of the total advances of all banks at the end of 1953 and Rs. 9 crores was only 0.7 per cent. of all the advances at the end of 1961. Here also, the percentage has dropped considerably and is very low in itself.

In any country, in which under a planned economy, its Government has complete control of capital issues and industrial licensing, exercises vast powers of direction and regulation at every stage of manufacture, movement and distribution of a wide range of commodities, and owns and manages a large and increasing number of productive undertakings, the concentration of economic power is bound to be in the hands of the Government and not in the hands of the industrialists belonging to the private sector.

The large amount of credit granted by the banks may create the impression that their Boards of Directors have vast powers. In practice, however, the total credits are composed of and reflect thousands of decisions taken daily by managers of 5,000 branches of banks in the country in giving advances to customers within limits allowed to them and administrative instructions issued to them by their head offices and directives issued by the Reserve Bank of India. Bank lending is highly individualistic and decentralized, because the managers of branches have to process and sanction thousands of loan applications every year in accordance with their intimate knowledge of local conditions and their judgment regarding the solvency and profit-earning capacity of the business they are financing.

On the other hand, in any country, where large undertakings are owned and managed by the State, a large degree of centralization and concentration of power prevails in their working. The powers to take decisions in such organizations are centralized in their head offices, so that little initiative or incentive is left to their branch or departmental managers who have merely to put up their proposals to the central office and carry out its instructions. Moreover, the centralization produces such a degree of standardization and uniformity that flexibility and individual discretion are replaced by procedural delays and rigidities which are very annoying to the customers as well as the staff. Thus, the personal touch which is essential in all business is lost and customer consciousness is absent. It is well-known that the responsiveness of public undertakings to their customers and the public is much less than that of undertakings in the private sector.

If banking is nationalized, managers of bank offices all over the country would be deprived of their initiative and power to take decisions and would have to refer most things to the central organization and carry out its instructions. In India, where promotion of free enterprise side by side with a large and growing public sector is an accepted goal of state policy, such a concentration of power in the functioning of banking offices from day to day and particularly in the grant of credit would result in a complete loss of freedom of enterprise, a great loss of vitality of economic action and, therefore, a much slower rate of the growth of the national economy. This would delay, instead of promoting, the realization of the goal of banishing poverty and raising the standard of life of the nation.

Further, the shareholders of the banks number several tens of thousands and each of them, in a large majority of cases, has a small holding. The ownership of banks, therefore, is spread among a large number of people belonging to many walks of life.

The fact that a small percentage of banks control a large percentage of deposits in the country is due to the existence of a small number of large banks with an all-India character, a wide network of branches and large deposits, and a large number of small banks purely local in character and, therefore, having a small number of branches in local areas and small deposits. During the last 10 years, largely under the advice of the Reserve Bank, the number of small banks has been reduced from over 500 to 220 by means of liquidations and amalgamations, as it was found that they were poorly managed and were not financially viable. The present policy of the Government and the Reserve Bank of India, however, is to improve the working of the small banks, to make them viable and to help them to become larger, as far as practicable. There is no point in condemning large banks, because they have been successful in mobilizing large resources from different parts of the country and employing them for national productive activities.

The Imperial Bank of India, which was a joint-stock bank, was nationalized on 1st July 1955 and became the State Bank of India. The total number of offices of the latter in the Indian Union at the end of 1955 was 484. The number increased to 1,002 by the end of 1962, showing an increase of 518 officers. The offices of the other scheduled banks between the end of 1955 and 1962 increased from 2,307 to 3,544 *i.e.* by 1,237. This increase in the number of offices of the other scheduled banks was brought about in spite of the fact that they lacked certain advantages which were enjoyed by the State Bank of India.

As agent of the Reserve Bank of India, the State Bank of India enjoys a special position in the money market. Balances of the Central and State Governments are kept with its offices in all those places where the Reserve Bank of India does not have offices. In addition, confidential directives have been issued and pressure has been exercised by the Government to make autonomous and semi-Government bodies keep their funds with the State Bank of India. Finally, the State Bank of India is given a subsidy out of the Development and Integration Fund for meeting losses on the working of its offices. During 1957-1961, the State Bank received

Rs. 81 lakhs from this Fund for this purpose. The other scheduled banks lack these advantages, but they make up for it by greater zeal and alertness.

It therefore, cannot be said that the Indian joint-stock banks would be able to establish new offices more rapidly if they were nationalized. The fact is that establishment of new banking offices involves large capital expenditure in the form of acquiring premises, building up establishments, recruiting and training additional staff, etc. during the initial years and they do not pay their way for the first few years. Moreover, it is difficult to open them in several places owing to the lack of transport, security and remittance facilities. Even the State Bank of India is compelled by these difficulties to slow down the pace of its branch expansion and to consolidate the growth already achieved by it, in spite of the advantages, mentioned above, enjoyed by it. Nevertheless, it is understood that several banks have submitted to the Reserve Bank, for its approval, as desired by it, extensive programmes for establishing new branches during the next three years.

As regards the mobilization of resources also, the achievements of the other scheduled banks compare favourably with those of the State Bank of India, although, as mentioned above, they lack the special advantages which are enjoyed by the State Bank of India. Between the end of 1955 and 1961, the deposits of the State Bank of India (exclusive of P. L. 480 and 665 Funds) increased from Rs. 205 crores to Rs. 382 crores, *i.e.* by 86 per cent. During the same period, the deposits of the other scheduled banks increased from Rs. 823 crores to Rs. 1,546 crores, *i.e.* by 88 per cent. The other scheduled banks have had to make great efforts to mobilize their resources. They have taken the form of establishing new branches, resorting to advertisement and publicity in a variety of ways and offering newer and better services to the public. It is doubtful whether they would be equally alert, if they were to be nationalized.

The following percentages given by the Reserve Bank of India in its *Trend and Progress of Banking in India during* 1961 of advances made by scheduled banks according to purpose in 1961 show that the allegation that joint-stock banks in their lending operation neglect industry and encourage speculative activities is not correct.

ANALYSIS OF ADVANCES OF BANKS
ACCORDING TO PURPOSE IN 1961.

I.	Industry	...		... 54%
II.	Commerce	...		... 34%
	A. Trade	...	29%	
	*B. Financial	...	5%	
III.	Agriculture	...		... 1%
IV.	Personal	...		... 8%
V.	Professional	...		... 1%
VI.	Others	...		... 2%
				100%

* Of this, the advances to dealers in Government securities, shares and bullion were only 1.8%.

The fact that more than half of the total advances of banks are made to industry shows that they are playing their proper part in bringing about a rapid industrial development of the nation. There is little scope for them for financing speculative activities even under 'Commerce', because their advances in this group have to be made according to directives issued by the Reserve Bank to them from time to time, imposing selective controls which lay down that banks cannot make advances of more than certain amounts against different commodities and must provide for certain minimum margins. Personal advances are given by banks to their customers, who are generally not traders, for meeting their personal needs. Further, clean advances, *i.e.* advances given on the personal security of the borrowers, and not against commodities, are given to customers (companies or firms) of very high financial standing and are used by them for productive purposes. Financing the movement of commodities or manufactured goods from the points of production or manufacture to the markets and of stocking them until they are required by the consumers is financing of an essential productive and distributive activity, because the act of production and distribution is not complete until the commodities or manufactured goods reach the consumers.

Banks can finance only those beneficial schemes which are calculated to yield an adequate financial return immediately or after short periods. They cannot finance relief works or development schemes, which may be of great social benefit but which

are not calculated to yield a financial return immediately or after short periods. The reason is that the bulk of the funds which banks use for making advances are not their own funds but are deposits which are their liabilities and which must be returned to the depositors on demand or after short periods. Banks cannot make any use of the deposits, which would conflict with their duty towards their depositors, in the form of maintaining the safety of the deposits. Even nationalized banks would not be able to ignore this fundamental principle of banking. If they abandon it, they would not be banks at all. Moreover, if the depositors of nationalized banks find that their deposits are used by the banks for financing schemes of relief or social development, which cannot be expected to yield a financial return immediately or after a short period, they would lose their confidence in the banks and withdraw their deposits, thereby making the functioning of the banks impossible.

This does not mean that schemes of relief and social development should go unfinanced. They ought to be financed, but the financing can be done either by Government itself or by special agencies created by Government and backed by it. Joint-stock banks do help Government liberally in India by subscribing annually to Government loans and it is these loans which provide an appreciable part of the funds which enable Government to achieve such social objectives. In fact, the investments of scheduled banks touched a peak of Rs. 711 crores in October 1962 and constituted almost one-third of their total resources. Further, with the imposition of a higher liquidity ratio, *i.e.* ratio of cash, bullion and unencumbered securities to deposits by the latest banking legislation, the investments of banks in Government securities are bound to increase further in future.

It is true that credit given by joint-stock banks to agriculturists, co-operative institutions and small industries constitutes a very small proportion of the total bank credit. But this is due to the fact that these borrowers lack credit-worthiness. The risk of loss in giving loans to them is very great. For the last two decades, the Reserve Bank of India, which is not, and need not be, guided strictly by consideration of earning a profit, has been offering liberal credit facilities at concessional rates of interest to different types of co-operative institutions, to enable them to provide finance to agriculturists and small industrialists, who may not be credit-worthy but who possess productive potential. But its short-term

loans given to these institutions during 1962 came to Rs. 186 crores and its outstanding medium and long-term loans to them at the end of March 1962 to Rs. 67 crores only. In this connection, the following remarks of Mr. H. V. R. Iengar, former Governor of the Reserve Bank of India, are worth quoting :[1]

"In the meanwhile, there is a tendency for pressures to develop against the Reserve Bank for increased accommodation for co-operative banks. These pressures take the form of demanding that the Reserve Bank should, irrespective of the soundness of particuler banks and merely because the need for credit on the part of the farmer is manifest, grant accommodation on the basis of the farmer's needs rather than on the basis of his repaying capacity. In some quarters, the Reserve Bank has been characterized as conservative or old-fashioned and lacking in the dynamic urge. Fortunately, in India, the Bank has been able to resist such pressures and in this it has the strong support of Government."

Government and the Reserve Bank of India have been putting forth their best efforts to make the co-operative movement successful but its impact on agriculture and small industries has so far been insignificant. This is so because offering liberal credit facilities even at concessional rates has not made the movement self-supporting and the borrowers creditworthy. It is for the Government departments concerned and community development schemes to build up their creditworthiness and unless this is done, no amount of credit made available to them will ever make these sectors of the Indian economy strong and viable.

Even if joint-stock banks were nationalized, no substantial improvement is likely in this field. This is indicated by the experience of the State Bank of India. Although it has endeavoured to do much pioneering work in providing credit to these sectors of the economy, the credit provided by it still remains insignificant.

Even if joint-stock banks are nationalized, they would not be able to replace the profit motive by the service motive in their operations. The State Bank of India itself made a profit of Rs. 2.69 crores in 1962. It is not consistent with any banking principles or practice to lend money for schemes which are not expected to make a profit or at least to pay their way. Moreover, planning implies an optimum use of resources. Unless nation-

1 *Monetary Policy and Econonuc Growth*, by H.V.R. Iengar, p. 212

it will be impossible to determine whether they are utilizing their resources in the best manner possible. Moreover, the nationalized banks will be accountable to the nation, through Parliament. ~~alized banks maintain a commercial approach in their operations,~~ Parliament, and even the Ministry of Finance, will not be able to evaluate the performance of the nationalized banks, unless they follow strictly the banking and accounting principles.

It is too much to expect that joint-stock banks, when nationalized, will receive better co-operation from their employees. The experience of the Reserve Bank of India, the State Bank of India, the Life Insurance Corporation and other undertakings in the public sector in this respect has been no better than that of the joint-stock banks. It is well-known that the relations between their managements and their employees have not been cordial and that the former have numerous complaints to make regarding the un-co-opertive attitude of the latter. With regard to the efficiency of the services rendered to the customers, it cannot be said that the State Bank of India is doing better than the joint-stock banks.

It is true that the gross emoluments of the top executives of the larger joint-stock banks are appreciably higher than those of their fellows in most of the undertakings in the public sector. But their net emoluments are only a little higher, because most of the difference between the gross emoluments of the two sets of executives is taken away by Government by higher rates of income and super taxes, which increase very steeply in the case of higher incomes. Thus, the differences in the gross emoluments constitute mostly a psychic income, which serves as an incentive to the top executives of the banks for putting forth their best efforts to make their respective banks efficient and alert in rendering newer, better and quicker services to their customers.

There is a good deal of substance in the above reply given by those who are not in favour of the nationalization of banks in India to the arguments which have been advanced by those who favour nationalization. However, there are several defects in the present working of the banks in India. Some of the chapters of this book have dealt with them. Managements of banks should do their best to remove them, as early as possible, with the help of the Reserve Bank of India.

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